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If you sell or otherwise transfer, or have sold or otherwise transferred, all your Imperial Shares, please forward this document, but not the accompanying personalised Form of Proxy, as soon as possible to the purchaser or the transferee, or to the bank, stockbroker or other agent through whom the sale or transfer was effected, for transmission to the purchaser or the transferee. If you sell or have sold or otherwise transferred only part of your holding of Imperial Shares, you should retain these documents and consult the bank, stockbroker or other agent through whom the sale or transfer was effected.

This document should be read as a whole. Your attention is drawn to the letter from the Chairman of the Company which is set out in Part 2 of this document and which contains a recommendation from the Board that you vote in favour of the Resolution to be proposed at the General Meeting referred to below. Your attention is also drawn to the risk factors which are set out in Part 3 of this document.



## **Imperial Tobacco Group PLC**

(a public company incorporated in England and Wales with registered number 03236483)

### **Proposed Acquisition of certain U.S. cigarette and e-cigarette Brands and assets currently owned by Reynolds American Inc. and Lorillard, Inc.**

#### **Circular to Shareholders and Notice of General Meeting**

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Notice of a General Meeting of the Company, to be held at the Bristol Marriott Hotel City Centre, 2 Lower Castle Street, Old Market, Bristol, BS1 3AD at 3:00 p.m. or immediately following the conclusion of the Company's AGM, whichever is the later, on 28 January 2015, is set out at the end of this document. Whether or not you intend to be present at the General Meeting, you are asked to complete and return the Form of Proxy in accordance with the instructions printed on it as soon as possible and, in any event, so as to be received by Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom by no later than 3:00 p.m. on 26 January 2015 (or, in the case of an adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting). Shareholders wishing to appoint a proxy online should visit [www.sharevote.co.uk](http://www.sharevote.co.uk) and follow the instructions. Alternatively, if you have already registered with Equiniti's online portfolio service, Shareview, you can submit your proxy form at [www.shareview.co.uk](http://www.shareview.co.uk). If you hold your Ordinary Shares in uncertificated form (i.e. in CREST) you may appoint a proxy by completing and transmitting a CREST proxy instruction in accordance with the procedures set out in the CREST Manual so that it is received by Imperial's agent (under CREST participant RA19) by no later than 3:00 p.m. on 26 January 2015. CREST members may choose to use the CREST electronic proxy appointment service in accordance with the procedures set out in the notes accompanying the Notice of General Meeting.

A summary of the actions to be taken by Shareholders is set out on page 15 of this document and in the Notice of General Meeting set out at the end of this document.

This document is a circular relating to the Acquisition which has been prepared in accordance with the Listing Rules of the FCA made under section 73A of the FSMA. This document has been approved by the FCA.

Credit Suisse, which is authorised in the U.K. by the Prudential Regulation Authority and regulated in the U.K. by the FCA and the Prudential Regulation Authority, is acting exclusively for the Company and for no one else in connection with the Acquisition, the content of this document and other matters described in this document. Credit Suisse will not regard any other person as its client in relation to the Acquisition, the content of this document and other matters described in this document and will not be responsible to anyone other than the Company for providing the protections afforded to its clients, nor for providing advice to any other person in relation to the Acquisition, the content of this document or any other matters described in this document.

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## **FORWARD LOOKING STATEMENTS**

Certain statements contained in this document or incorporated by reference into it constitute, or may be deemed to constitute "forward looking statements" with respect to the financial condition, results of operations and business of the Imperial Group and, upon completion of the Acquisition, the Enlarged Group and certain plans and objectives of the Directors with respect thereto. These forward looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward looking statements often use forward-looking terminology including words such as "anticipate", "target", "expect", "estimate", "intend", "plan", "projects", "goal", "believe", "will", "may", "should", "would", "could" or other words of similar meaning. These statements are based on assumptions and assessments made by the Directors in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe appropriate. By their nature, forward looking statements involve risk and uncertainty, because they relate to events and depend on circumstances that will occur in the future and the factors described in the context of such forward looking statements in this document could cause actual results and developments to differ materially from those expressed in or implied by such forward looking statements.

The principal risks and uncertainties facing the business are discussed in the section headed "Risk Factors" in Part 3 of this document.

The forward-looking statements contained in this document speak only as at the date of this document. Except to the extent required by applicable law, the Listing Rules or the Disclosure and Transparency Rules, the Company will not necessarily update any of them in light of new information or future events and undertakes no duty to do so. Shareholders should note that this paragraph is not intended to qualify the statements as to working capital set out in paragraph 12 of Part 6 of this document.

## **MARKET DATA**

World data and individual market data referred to in this document with respect to the Imperial Group and its competitors are internally generated management estimates derived, where available, from a variety of sources, including internal sales data, factory sales information provided by tobacco manufacturers and importers, customs data, trade journals, publications and governmental statistics, as well as independently compiled market research statistics derived from point of sale surveys and trade questionnaires. In common with industry practice, China is excluded from global data, including market share and market size statistics, unless otherwise indicated. Unless the context otherwise requires, market size and share data referred to herein with respect to the Imperial Group and its competitors refer to unit sales in the relevant financial year or relevant six month period.

## **DEFINITIONS**

Capitalised terms contained in this document have the meanings set out in Part 7 of this document.

## **DATE**

This document is dated 15 December 2014.

## **CORPORATE DETAILS AND ADVISERS**

<b>Registered Office</b>	Imperial Tobacco Group PLC 121 Winterstoke Road Bristol BS3 2LL
<b>Sponsor and Financial Adviser to the Company</b>	Credit Suisse Securities (Europe) Limited One Cabot Square London E14 4QJ
<b>Financial Adviser to the Company</b>	Goldman Sachs International Peterborough Court 133 Fleet Street London EC4A 2BB
<b>Reporting Accountants</b>	PricewaterhouseCoopers LLP 1 Embankment Place London WC2N 6RH
<b>Legal Adviser to the Company</b>	Allen & Overy LLP One Bishops Square London E1 6AD
<b>Legal Adviser to the Sponsor</b>	Davis Polk & Wardwell London LLP 99 Gresham Street London EC2V 7NG
<b>Registrar</b>	Equiniti Limited Aspect House Spencer Road Lancing West Sussex BN99 6DA

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## PART 1

### EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Latest time and date for receipt of Form of Proxy and receipt of electronic proxy appointments by registered Shareholders for the General Meeting .....	3:00 p.m. on 26 January 2015
General Meeting .....	3:00 p.m. or immediately following the conclusion of the Company's AGM, whichever is the later, on 28 January 2015
Expected completion of the Acquisition .....	prior to the Company's half-year results 2015

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**Notes:**

- (1) This timing is indicative only and is subject to change. If any of the above times and/or dates change, the revised times and/or dates will be notified to Shareholders by announcement through the London Stock Exchange and will be available on [www.imperial-tobacco.com](http://www.imperial-tobacco.com).
- (2) All references to time in this timetable are to London U.K. time unless otherwise stated.

**PART 2**  
**LETTER FROM THE CHAIRMAN**



**Imperial Tobacco Group PLC**

(Incorporated and registered in England and Wales with registered number 03236483)

**Registered and Head Office**  
Imperial Tobacco Group PLC  
121 Winterstoke Road  
Bristol  
England  
BS3 2LL

**Directors**

Mark Williamson	Chairman
Alison Cooper	Chief Executive
Oliver Tant	Chief Financial Officer
Matthew Phillips	Corporate Affairs Director
Ken Burnett	Non-Executive Director
David Haines	Non-Executive Director
Michael Herlihy	Senior Independent Non-Executive Director
Karen Witts	Non-Executive Director
Malcolm Wyman	Non-Executive Director

15 December 2014

Dear Shareholder

**Proposed Acquisition of certain U.S. cigarette and e-cigarette Brands and assets currently owned by Reynolds American Inc. and Lorillard, Inc.**

**1. Introduction**

On 15 July 2014, Imperial announced that it and its wholly owned subsidiary, Lignum-2, L.L.C. (subsequently renamed ITG Brands, LLC), had entered into an Asset Purchase Agreement with Reynolds for the acquisition of certain brands and assets currently owned by the Reynolds Group and the Lorillard Group, including the U.S. cigarette brands *Winston*, *Maverick*, *Kool* and *Salem*, and the U.S. and international e-cigarette brand *blu*, plus the national sales force, offices and production facilities currently owned by Lorillard. The Acquired Tobacco Cigarette Brands are to be acquired without historic product liabilities following the proposed acquisition of Lorillard by Reynolds. Under the terms of the Asset Purchase Agreement, ITG Brands will pay total cash consideration of US\$7.056 billion (approximately £4.2 billion)<sup>1</sup>.

Due to the size of the Acquisition in relation to the size of Imperial, the Acquisition constitutes a Class 1 transaction (as defined in the Listing Rules) and requires the approval of Imperial's Shareholders pursuant to the Listing Rules. The Acquisition is conditional on, among other things, such approval being given. Accordingly, a General Meeting is being convened on 28 January 2015 at 3:00 p.m. or immediately following the conclusion of the Company's AGM, whichever is the later, at the Bristol Marriott Hotel City Centre, 2 Lower Castle Street, Old Market, Bristol, BS1 3AD at which the Resolution approving the Acquisition will be proposed.

The Board unanimously considers that the Acquisition is in the best interests of Imperial and its Shareholders as a whole and recommends that Shareholders vote in favour of the Resolution.

I am writing to you to give you details of the Acquisition, including the background to and reasons for the Acquisition, to explain why the Board considers the Acquisition to be in the best interests of Imperial and its Shareholders as a whole, and to seek your approval of the

<sup>1</sup> Converted at an exchange rate of US\$1.70:£1, being the exchange rate used in the announcement made on 15 July 2014.

Resolution to be proposed at the General Meeting. A notice convening the General Meeting is set out in Part 8 of this document. The actions you should take to vote on the Resolution, and the recommendation of your Board, are set out in paragraphs 11 and 13 respectively of this letter.

#### 1.1 *Information on the Imperial Group and our strategy*

We are an international fast moving consumer goods company with a long track record of creating value for our shareholders. We are the world's fourth largest international tobacco company with a portfolio that spans the entire tobacco spectrum.

We have a history of successful acquisitions which have expanded and diversified our business to generate returns for our shareholders. In more recent years we have been focused on strengthening our portfolio and our footprint to build a stronger platform for growth, while continuing to assess opportunities for further acquisitions that would represent value for shareholders and strategically enhance our business.

We apply consumer insights and our sales growth driver expertise to generate quality sustainable growth whilst developing opportunities for additional long-term revenue growth through our standalone business, Fontem Ventures, which is dedicated to the development of innovative non-tobacco products. We are optimising our portfolio to drive the performance of our Growth Brands and Specialist Brands. These are our most important brands and generate more than half our total tobacco net revenue. Growth Brands have strong consumer appeal and several have been developed into total tobacco offerings, providing consumers with cigarette and fine cut tobacco smoking experiences. Specialist Brands appeal to specific consumer groups and include a range of cigarette, fine cut tobacco, paper, cigar and smokeless tobacco brands.

We manage our markets by the strategic role they play, not by geographic location, with markets prioritising growth or returns. Our Growth Markets have large profit and/or volume pools and include selected markets in the EU, Eastern Europe, Asia, the Middle East and the U.S. We typically have shares below 15 per cent. in these markets and our priority is to drive long-term share and profit growth. Our Returns Markets tend to have declining volumes and include Australia and markets in the EU, Eastern Europe and Africa. Most of our shares are above 15 per cent. in these markets and our priority is to grow profits and actively manage our strong share positions.

We make, market and sell our brands and products in a way that is financially, socially and environmentally responsible, and ensure that our products are promoted responsibly to adult consumers in accordance with local regulation, legal obligations and our international marketing standards.

Our overall objective is to maximise sales, cost and cash opportunities and realise the potential of our portfolio, market footprint and people, in order to generate sustainable returns for our shareholders.

#### 1.2 *Acquisition rationale*

With total acquisitions of over £17 billion since listing on the London Stock Exchange in 1996, we have a long track record of successful acquisitions which have expanded the geographic reach and product offerings of the Imperial Group.

This investment in the U.S., one of our key Growth Markets, provides an opportunity to transform our presence in the world's largest tobacco profit pool (excluding China). The Acquisition will enhance our product portfolio through the addition of tobacco brands which, despite being relatively unsupported in recent years, continue to demonstrate strong inherent brand equity with consumers. In addition, the acquisition of an established and experienced sales force, national distribution capabilities and a respected management team, will transform the scale and presence of our U.S. business, enabling us to become a stronger and more effective competitor.

Your Board believes that the Acquisition will create significant value for shareholders. The Acquisition is expected to deliver a return on investment of over 10 per cent., well in excess of Imperial's weighted average cost of capital in the first full financial year following completion of the Acquisition. In addition, the Acquisition is expected to be significantly earnings enhancing in the first full financial year following its completion.



## 2. Information on the U.S. cigarette market

The U.S. cigarette market is the third largest in the world by volume (excluding China) with the latest market volume data for the 12 months to the end of September 2014 indicating a total U.S. market size of around 266 billion cigarettes. In profit terms, the U.S. market is the largest in the world (excluding China), accounting for up to 25 per cent. of world cigarette profits (excluding China). Estimated total profits of the cigarette industry in the U.S. for calendar year 2014 are expected to be in excess of US\$15 billion based in part on net sales for the 12 months to the end of September 2014 of over US\$33 billion.

Although the U.S. cigarette market is in modest volume decline (estimated 4.2 per cent. moving annual total to September 2014), the U.S. profit pool has grown by an estimated average of 4.5 per cent. each year over the last ten years. This has been driven in part by cost savings and in part by price increases, reflecting the affordability of cigarettes in the U.S. market relative to local purchasing power. The U.S. regulatory environment has tended to be relatively stable. The FDA has historically adopted a largely scientific and evidence based approach to the evolution of policy, driving a measured approach to regulatory change.

## 3. Information on the Acquired Assets

### 3.1 Overview

On completion of the Acquisition, we will acquire:

- U.S. rights in the *Winston*, *Kool* and *Salem* cigarette brands, currently owned by the Reynolds Group (the *Winston* cigarette brand is owned by Japan Tobacco Inc. outside of the U.S.);
- U.S. rights in the *Maverick* cigarette brand, currently owned by the Lorillard Group;
- all rights, both in the U.S. and internationally, in the e-cigarette brand *blu* as owned by the Lorillard Group and its existing e-cigarette operations in the U.S. and U.K.; and
- the Lorillard Group's manufacturing facilities at Greensboro, North Carolina, U.S., and other commercial infrastructure currently owned by the Lorillard Group, along with the majority of the national sales force of the Lorillard Group.

Further details on the Acquired Assets are set out below.

### 3.2 Cigarette Brands

*Winston* is currently the number seven brand in the U.S. with around 2.1 per cent. share of the U.S. market. Market research in the U.S. suggests that it retains strong brand awareness and consumer resonance notwithstanding that it has not been one of Reynolds' key focus brands, and has had very limited investment for a number of years.

The States in which *Winston* is strongest are largely those which have the most material volumes of cigarette sales in the U.S. tobacco market and the majority of the States in which *Winston's* market share exceeds its national average are in the top 20 States by volume of cigarette sales.

*Maverick* is a discount brand with around 2.0 per cent. share of the U.S. market, though it is significantly stronger than this in several key volume States and has grown from a market share of around 0.3 per cent. in 2008.

*Kool* is a menthol brand and represents around 1.8 per cent. of the U.S. market. Although Reynolds refined its brand portfolio during 2008 and reclassified *Kool* (which had a market share of 3.1 per cent. in 2007) from a growth brand to a support brand, it has a generally very loyal base of core consumers which is reflected in its current share of the market.

*Salem* is also a menthol brand with around 1.2 per cent. U.S. market share.

All of these cigarette brands are to be acquired without historic product liabilities. An indemnity in respect of such liabilities will also be provided by Reynolds under the terms of the Acquisition. Please refer to paragraph 2.6 of Part 4 of this document for more information.

### 3.3 E-Cigarettes

*blu* is a leading e-cigarette brand in the U.S., generating US\$202 million net revenue in aggregate sales in the U.S. and the U.K. for the 12 months ended 30 September 2014. The e-cigarette market has been growing strongly in the U.S. in recent years with the market more



than doubling every year since 2009. The e-vapour market, of which the e-cigarette market forms a part, is now estimated to exceed US\$2.5 billion in total, including a growing online marketplace.

### 3.4 *Other Assets*

In addition to the portfolio of Brands, further assets to be acquired include the Lorillard Group's manufacturing facilities (capacity of approximately 50 billion cigarettes per annum) and offices at Greensboro, North Carolina in addition to the majority of the sales force and commercial infrastructure of the Lorillard Group. As of 31 December 2013, the Lorillard Group had approximately 2,900 full-time employees.

### 3.5 *Financial Information*<sup>2</sup>

The table below provides summary financial information on the Acquired Assets for the 12 months ended 30 September 2014, on the Imperial Group for the financial year ended 30 September 2014 and for the Pro Forma Enlarged Group (as set out in Section G of Part 5 of this document):

	<i>Acquired Assets (for the 12 months ended 30 September 2014)</i>		<i>Imperial Group (for the year ended 30 September 2014)</i>	<i>Pro Forma Enlarged Group (for the year ended 30 September 2014)</i>
	<i>(US\$ bn)</i>	<i>(£ bn)<sup>3</sup></i>	<i>(£ bn)</i>	<i>(£ bn)</i>
<i>Net revenue<sup>4</sup></i>	2.0	1.3	6.6	7.8 <sup>5</sup>
<i>Adjusted EBITDA<sup>6</sup></i>	0.7	0.5	3.3	3.8

The Brands that are the subject of the Acquisition had volumes of 18 billion cigarettes for the 12 months ended 30 September 2014, and the Imperial Group had volumes of 294 billion cigarettes for the 12 months ended 30 September 2014. Accordingly, the Enlarged Group would have had combined volumes of 312 billion cigarettes for the 12 months ended 30 September 2014.

Historically, the *Winston*, *Kool* and *Salem* Brands (and their related business operations) have been, and until the day of completion of the Merger will continue to be, owned and managed by the Reynolds Group, and the *Maverick* and *blu* Brands (and their related business operations) have been, and until the day of completion of the Merger will continue to be, owned and managed by the Lorillard Group. Accordingly, the historical financial information contained in Part 5 of this document is presented in two separate financial track records for each of the Reynolds Group and the Lorillard Group as set out below:

- (a) the Reynolds Business historical financial information in Section B of Part 5 and the Reynolds interim financial information in Section C of Part 5 reflect the assets, liabilities, revenues and expenses directly attributed to the Acquired Assets owned, as at the date of this document, by the Reynolds Group; and
- (b) the Lorillard Business historical financial information in Section E of Part 5 and the Lorillard interim financial information in Section F of Part 5 reflect: (i) the assets, liabilities, revenues and expenses attributed to the Acquired Assets owned, as at the date of

<sup>2</sup> The financial information, from which the figures included in paragraph 3.5 have been extracted, has been prepared in accordance with IFRS and on a basis consistent with Imperial's accounting policies.

<sup>3</sup> Except as otherwise stated, the conversion rate from US\$ to £ in this document is at an exchange rate of US\$1.6188:£1 being the rate of exchange as at 30 September 2014.

<sup>4</sup> The previously announced combined net revenue of US\$2.4 billion related to the year ended 31 December 2013 and included additional revenue arising in respect of contract manufacturing leaf costs which have now been excluded from the US\$2.0 billion *pro forma* combined net revenue amount. In addition, the net revenue stated for the Imperial Group and the Pro Forma Enlarged Group excludes logistics revenue of the Imperial Group as set out in Section G of Part 5 of this document.

<sup>5</sup> This figure reflects the calculation set out in Section G of Part 5 of this document rather than the addition of figures shown in the other columns of this table (as all figures have been rounded for the purposes of this table).

<sup>6</sup> Adjusted EBITDA is stated pre any offset to volume adjustment related to industry profits, restructuring costs and acquisition accounting adjustments.

this document, by the Lorillard Group; and (ii) the revenue earned and expenses incurred by the Lorillard Group on the other Lorillard brands which will be manufactured for the Reynolds Group under the Reciprocal Manufacturing Agreement.

Additionally, *pro forma* financial information illustrating the impact of the Acquisition on Imperial's latest financial information is set out in Section G of Part 5 of this document. This incorporates a reconciliation of operating profit to adjusted EBITDA, including an explanation of certain non-recurring items.

The Brands that are the subject of the Acquisition had *pro forma* combined net revenue of US\$2.0 billion (£1.3 billion)<sup>7</sup>, *pro forma* combined brand contribution of US\$1.1 billion (£0.7 billion), *pro forma* combined adjusted earnings before interest, taxes, depreciation and amortization of US\$0.7 billion (£0.5 billion) and *pro forma* combined operating profit of US\$0.6 billion (£0.4 billion). As set out in the *pro forma* financial information in Section G of Part 5 of this document, the book value of the gross assets that are the subject of the Acquisition was approximately US\$0.7 billion (£0.4 billion) as at 30 September 2014 (which amount excludes tax assets and current assets which are not being acquired as part of the Acquisition).

In line with our expectations at the time of our announcement in July 2014, the financial performance of the Brands that are the subject of the Acquisition has declined slightly during 2014, with combined adjusted EBITDA for the 12 months to September 2014 of US\$0.7 billion, compared to the US\$0.8 billion which we previously disclosed, and which was based on the historical financial information for the acquired assets for the 12 months to December 2013.

This reflects continued gradual decline in combined market share of the *Winston*, *Salem* and *Kool* Brands, costs associated with launching the *blu* Brand in the U.K. in the second quarter of 2014, and the negative impact on *blu*<sup>8</sup> of competitors' new product launches in the U.S., which have been supported by aggressive promotional programmes.

#### **4. Background to and reasons for the Acquisition**

Since listing on the London Stock Exchange in 1996, we have established a track record for acquiring and successfully integrating businesses, expanding our geographic reach, driving cost efficiencies, building brand equity and enhancing earnings.

Your Board believes that the Acquisition represents a significant opportunity to strengthen the Imperial Group's product portfolio, build a competitive position in a key Growth Market and further enhance the sustainability of its earnings and cashflow. The Acquisition:

- is expected to generate a return on invested capital of over 10 per cent., well in excess of our weighted average cost of capital in the first full financial year following completion of the Acquisition; and
- is expected to be significantly earnings enhancing in the first full financial year following completion of the Acquisition.

In addition, we believe that the Acquisition will be transformational for our U.S. business and e-cigarette business by:

- enhancing our portfolio of tobacco brands in the U.S. which, with a greater share of the market, makes us more important to retailers and more appealing to consumers;
- providing the opportunity for leadership in e-cigarettes, and for us to combine *blu* with our Fontem Ventures category know-how to allow us to explore international growth opportunities as the market develops; and
- enhancing the U.S. management team, sales force capability and wider infrastructure, allowing us to benefit from the best of both businesses.

##### *Stronger U.S. competitor*

The addition of *Winston*, *Maverick*, *Kool* and *Salem* will strengthen our existing U.S. portfolio, which currently accounts for around 3 per cent. of the U.S. market share, transforming the Imperial Group into a major U.S. competitor with a total market share of approximately 10 per cent.

<sup>7</sup> Please see footnote 4 above.

<sup>8</sup> Lorillard's third quarter results, released on 23 October 2014, stated that *blu* had 29.7 per cent. U.S. market share as at 30 September 2014

When combined with *blu*, a leading brand in the U.S. in the developing e-cigarette category, the enlarged U.S. business will become increasingly important to wholesalers and retailers. A respected sales team with a proven track record will enable broader coverage of customers with more sales visits, space on shelf, merchandising and point of sale visibility, helping to grow our presence and influence within key retail and distribution accounts.

A key attraction of the Acquisition is that it will enable the Imperial Group to move from a focused presence in 19 States to a material presence across the whole of the U.S. Following completion of the Acquisition, we will have a national operation across the United States which will significantly improve our ability to compete and help realise our ambitions to grow.

#### *Stronger capabilities and platform for growth*

Martin Orlowsky, previously Chairman, President and CEO of Lorillard, is employed by Imperial as Executive Chairman Designate of our enlarged U.S. business and reports to Imperial Chief Executive Alison Cooper. He has an outstanding reputation in the industry from his highly successful track record at Lorillard. Prior to completion of the Acquisition his focus will continue to be on preparing the integration plan (as further described in paragraph 7 of this letter) and on planning for the implementation of our future strategy for the enlarged U.S. business.

In addition to acquiring brands, we will also acquire the vast majority of the former Lorillard Group sales force, who have a proven track record of success and a deep knowledge of brands and customers. Their experience, combined with a renewed focus on a portfolio of what are inherently strong, but historically underinvested brands, will create a stronger platform for growth.

#### *Expected synergies*

In combining the assets and resources of our existing Commonwealth-Altadis, Inc. business with those acquired as part of the Acquisition, we expect to realise modest synergies and our intention is to reinvest the savings from any such efficiencies to support the growth of the Brands.

### **5. Strategy for the enlarged U.S. business**

We have a clearly defined strategy to invest in Growth Markets, being those markets where we can grow our share of the available profit pool. The U.S. is one of our key Growth Markets given the size and growth of its profit pool and our under-representation in the market. We have a clear growth strategy for the Brands and our existing U.S. business which is set out below. In line with our prioritisation of Growth Brands throughout the rest of the Imperial Group it is anticipated that *Winston* and *blu* will be the main focus for our investment in the U.S. *Maverick*, *Kool* and our existing *USA Gold* brand will provide strong secondary support on a State-by-State basis.

- *Winston* will be the main focus of the strategy for our U.S. portfolio. Research in the U.S. has reinforced our confidence that *Winston* can be reinvigorated. It is a leading global brand owned by Japan Tobacco Inc. outside of the U.S. (global no.2 (excluding China)) which has strong inherent brand equity in the U.S. and has previously demonstrated its capability to grow when supported by increased investment. We plan to invest significantly in *Winston* and believe this investment and focus can unlock its inherent brand potential within the U.S. market.
- *blu* will be the focus of the brand portfolio in the e-cigarette segment as a leading e-cigarette brand in the U.S. In addition, the combination of the strong brand equity and technology platform of *blu* with the know-how and category expertise of our subsidiary Fontem Ventures will provide a platform for innovation. The e-cigarette market is still in an early stage of development, with considerable consumer interest suggesting opportunities for stronger branding and improved technology. We will therefore seek to build upon this platform, developing an already well-established U.S. consumer proposition and exploring opportunities for growth in international markets.
- *Maverick* will continue to be a focus, particularly in certain key volume States, in the discount segment of the market.

- *Kool*, an exclusively menthol brand with distinct regional strength, will benefit from investment on a State-by-State basis to build on its existing equity in States where there is a strong menthol demand or where we have identified strong potential for growth.
- Our existing *USA Gold* brand will continue to be a focus in its key volume States.
- The other brands in the portfolio, including *Salem*, will largely be managed to maximise cash returns.

We believe the implementation of this strategy for the enlarged U.S. business will succeed in creating significant value for Shareholders.

## 6. Principal terms of the Acquisition

### 6.1 *The Asset Purchase Agreement and interaction with the Merger Agreement*

On 15 July 2014, Reynolds, Lorillard and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds, entered into the Merger Agreement pursuant to which Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will, directly or indirectly, own 100 per cent. of the outstanding capital stock of Lorillard.

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands (a wholly-owned subsidiary of Imperial) and Reynolds entered into the Asset Purchase Agreement pursuant to which Reynolds has agreed, immediately following consummation of the Merger, to sell to ITG Brands certain assets used primarily in, or arising directly or indirectly out of the operation or conduct of, the businesses of the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*. Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands for no additional consideration the cigarette brand known as *Doral* in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months ended prior to the month in which completion of the Acquisition occurs falls below 4.9 per cent. (although this is not expected to be the case on the basis of current three-month market share data, and consequently the likelihood of acquiring *Doral* is currently assessed as low).

Imperial is a party to the Asset Purchase Agreement in the capacity of guarantor of certain of ITG Brands' obligations comprising: (i) the payment by ITG Brands of the purchase price when due; (ii) the full payment and performance of ITG Brands' obligations under the Asset Purchase Agreement to the extent such obligations are to be performed by ITG Brands at or prior to the completion of the Acquisition; and (iii) the payment by ITG Brands under any judgment against ITG Brands (or any related settlement) resulting from a breach of ITG Brands' obligations under certain agreements to be entered into between ITG Brands and Reynolds at completion of the Acquisition.

### 6.2 *Consideration*

The total cash consideration payable by ITG Brands to Reynolds will be US\$7.056 billion. The present value of the expected U.S. tax savings from the step-up in amortisation of intangibles is approximately US\$1.5 billion, giving a net consideration of approximately US\$5.6 billion.

### 6.3 *Overview of key terms of the Asset Purchase Agreement*

The *Winston*, *Kool*, *Salem* and *Maverick* Brands are to be acquired without historic product liabilities. An indemnity against such liabilities has been provided by Reynolds in the Asset Purchase Agreement to take effect from completion of the Acquisition (see paragraph 2.6 of Part 4 of this document). RJR Tobacco, a subsidiary of Reynolds, and Lorillard Tobacco, a subsidiary of Lorillard, are parties to settlements with States, including the MSA and other State settlements, which resolved actions that the States had brought against Philip Morris Incorporated (as predecessor to Philip Morris USA, Inc.), RJR Tobacco, and Lorillard Tobacco, among others, seeking to recover alleged health care costs related to smoking. Following completion of the Acquisition, ITG Brands expects, subject to certain exceptions, to make similar payments on future cigarette sales under the MSA and other State settlements in respect of the Acquired Tobacco Cigarette Brands as RJR Tobacco and Lorillard Tobacco now pay. ITG Brands and its affiliates (which had previously joined the MSA although they had not been

party to the original action by the States) expect to retain the “grandfathered share benefit” under the MSA for the current U.S. brands, under which they make no payments for certain market shares existing prior to the time they joined the MSA.

Completion of the Acquisition is conditional upon the fulfilment (or, where applicable, waiver) of the conditions set out in the Asset Purchase Agreement, which include, amongst other things:

- (a) approval by Imperial’s Shareholders at the General Meeting;
- (b) expiration or early termination of the waiting period under the HSR Act with respect to the Merger and, if applicable, the Acquisition, and, following Reynolds’ and Lorillard’s shareholder approval, the subsequent completion of the Merger; and
- (c) the absence of any law or governmental order that prohibits or materially restrains the sale or transfer of the Acquired Assets or the other transactions contemplated by the Asset Purchase Agreement.

Please also see the list of further conditions set out in paragraph 2.3 of Part 4 of this document.

Subject to the terms and conditions set out in the Asset Purchase Agreement, ITG Brands and Reynolds have agreed to cooperate with each other and use their reasonable best efforts to obtain all required authorisations, consents, orders and approvals in connection with the Acquisition and to reflect the agreed treatment of the Acquired Tobacco Cigarette Brands both before and after completion of the Acquisition.

The Asset Purchase Agreement contains various representations and warranties customary for a U.S. acquisition of the size and nature of the Acquisition.

The Asset Purchase Agreement also contains various other covenants customary for a U.S. acquisition of the size and nature of the Acquisition. Such covenants include cooperation with respect to receipt of all regulatory approvals, conducting the business relating to the Brands in the ordinary course of Reynolds’ business, and for Reynolds to ensure restrictions on Lorillard’s business operations, in each case as applicable in relation to the Acquired Assets between the signing of the Asset Purchase Agreement and the completion of the Acquisition.

The Asset Purchase Agreement further provides for the payment of termination fees by either ITG Brands or Reynolds upon a termination of the Asset Purchase Agreement in certain circumstances, including: (a) a termination fee of US\$210 million payable by Reynolds to ITG Brands in certain circumstances upon a termination of the Merger Agreement that results in the receipt by Reynolds of a termination fee under the Merger Agreement; and (b) a termination fee of US\$210 million payable by ITG Brands to Reynolds in certain circumstances in the event that the Imperial Board ceases to recommend the Acquisition to Shareholders or fails to include such recommendation in this document.

#### 6.4 *Transfer Agreement*

On 15 July 2014, ITG Brands and Lorillard entered into the Transfer Agreement, pursuant to which, immediately prior to the completion of the Merger, Lorillard will transfer specified Acquired Assets, including certain real estate assets, to ITG Brands and ITG Brands will assume specified liabilities from Lorillard, including under certain employee benefit plans. Such transfer of assets and assumption of liabilities under the Transfer Agreement is conditional on the satisfaction (or, where applicable, waiver) of the conditions to the Merger Agreement and the Asset Purchase Agreement.

#### 6.5 *Ancillary agreements*

On 15 July 2014, ITG Brands and Reynolds entered into the Route to Market Agreement pursuant to which they agreed that they will comply with certain obligations relating to the shelf space and wholesale channels in respect of the Acquired Tobacco Cigarette Brands before and after completion of the Acquisition.

Upon completion of the Acquisition, ITG Brands and RJR Tobacco will enter into the Reciprocal Manufacturing Agreement pursuant to which, for a transitional period, RJR Tobacco will exclusively manufacture and supply ITG Brands’ requirements for *Winston*, *Kool* and *Salem* brand products and, in certain circumstances, *Doral* brand products, and ITG Brands will exclusively manufacture and supply RJR Tobacco’s requirements for *Newport* brand products.

Further details of the Asset Purchase Agreement, the Transfer Agreement, the Route to Market Agreement and the Reciprocal Manufacturing Agreement are set out in Part 4 of this document.



## 7. Integration plan and employees

We have a strong track record of successfully integrating acquired businesses into the Imperial Group, and building on this previous experience we have put in place senior integration resources designed to ensure that the resulting enlarged U.S. business has a strong management team and draws on the strengths of both our existing U.S. business and the Acquired Assets.

Martin Orlowsky, further details of whom are provided in paragraph 4 of this letter, is employed by Imperial as Executive Chairman Designate of our enlarged U.S. business. Prior to completion of the Acquisition his focus will continue to be on preparing the integration plan and on planning for the implementation of our future strategy for the enlarged U.S. business. He will assume his appointed role on completion of the Acquisition to work on:

- the integration of the Acquired Assets with our existing U.S. business;
- the delivery of the interim arrangements covering supply and route to market with the Reynolds Group; and
- the implementation of the portfolio strategy for our enlarged U.S. business.

For the period up to completion of the Acquisition, interim arrangements will allow ITG Brands access to Lorillard's and Reynolds' management whilst preserving independence and confidentiality between the relevant parties.

As referred to above, once the Acquisition is completed, a transition period will commence during which RJR Tobacco will contract manufacture *Winston*, *Kool* and *Salem* and, in certain circumstances, *Doral* for ITG Brands and ITG Brands will contract manufacture *Newport* for RJR Tobacco and the parties will comply with certain obligations relating to the shelf space and wholesale channel in respect of the Acquired Tobacco Cigarette Brands. Please see further details of the Reciprocal Manufacturing Agreement and the Route to Market Agreement in Part 4 of this document.

## 8. Financing update and impact on Imperial

On 15 July 2014 we entered into committed bank facilities of £7.8 billion (equivalent)<sup>9</sup> comprising term loan and revolving credit facilities (the **Facilities**) pursuant to the Facilities Agreement. The aggregate principal amount of the term facilities is US\$7.1 billion, through which we propose to finance the Acquisition. The term loan facilities under the Facilities Agreement are split into three tranches and have a final maturity date of one year (subject to an extension option to extend the final maturity date to two years at Imperial's option), three years and five years respectively after the estimated date of completion of the Acquisition (or after the anniversary of the signing of the Facilities Agreement, if sooner). The revolving credit facilities under the Facilities Agreement may be applied towards refinancing certain of our existing bank facilities and indebtedness under debt capital markets issuances, to provide working capital and to finance payment of fees and expenses related to the Acquisition. Our existing core bank facility has been renegotiated on attractive terms, with a new five year term until July 2019. The revolving credit facilities under the Facilities Agreement are split into two tranches and have a respective final maturity date of three years (following the exercise of three six month extension periods by Imperial at its option) and five years (extendable beyond this period for a maximum of two years at the lenders' option) after the date of the Facilities Agreement. Primary syndication of the Facilities Agreement was completed on 29 August 2014 with the syndicate now comprising 17 lenders. Our financing requirements over the period to 31 March 2016 have been fully underwritten as part of the overall financing made available under the Facilities Agreement.

In order to accelerate the pace of debt repayment, we have suspended our share buy-back programme (approximately 14.2 million shares were bought back by the Company in our financial year 2014 at a cost of approximately £341 million). In addition, the rating agencies (Standard & Poor's, Moody's and Fitch) were consulted on the financial parameters arising from the Acquisition prior to announcement of the Acquisition and they have all since publicly announced that they expect that our investment grade credit ratings will be maintained following completion of the Acquisition.

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<sup>9</sup> Converted at exchange rates of US\$1.70:£1 and €1.25:£1, being the exchange rates used in the announcement made on 15 July 2014.

## 9. Current trading and prospects

On 4 November 2014, we published our preliminary results for the year ended 30 September 2014.

Tobacco net revenue was down 1 per cent. on a constant currency basis with adjusted earnings per share growing by 2 per cent. We noted an encouraging trading performance on an underlying basis for the financial year ended 30 September 2014, excluding the impact of the stock optimisation programme, with underlying tobacco net revenue up 2 per cent. and underlying adjusted earnings per share growing by 7 per cent. Underlying Growth Brand volume and underlying Growth Brand net revenue were up by 7 per cent. and 9 per cent. respectively.

Our strategy is about maximising sustainable returns for shareholders and we have four key operational priorities which underpin this. We are focussed on simplifying and strengthening our product portfolio, investing more in Growth and Specialist Brands. The development of our footprint involves targeting long-term share and profit growth in Growth Markets whilst prioritising sustainable profit and actively managing our share in Returns Markets. The ongoing optimisation of our cost base, which is driven by a reduction in overheads and product cost, helps fund investment in our portfolio and footprint. Finally we are committed to ongoing capital discipline, focussing in particular on improvements to working capital and cash conversion.

Trading conditions have continued to remain tough in many territories, however the actions taken across the business to enhance quality and sustainability will help to drive growth and create sustainable returns for our shareholders.

As at the latest practicable date, the Company continues to perform in line with the Board's expectations for the current financial year.

## 10. Risk Factors

For a discussion of the risks and uncertainties which you should take into account when considering whether to vote in favour of the Resolution, please refer to Part 3 of this document.

## 11. General Meeting and action to be taken

You will find set out at the end of this document a Notice of General Meeting convening a General Meeting to be held on 28 January 2015 at 3:00 p.m. or immediately following the conclusion of the Company's AGM, whichever is the later, at the Bristol Marriott Hotel City Centre, 2 Lower Castle Street, Old Market, Bristol, BS1 3AD.

At the General Meeting the Resolution will be proposed to approve the Acquisition. If passed, the Resolution will authorise the Acquisition, substantially on the terms and subject to the conditions of the Asset Purchase Agreement summarised in Part 4 of this document.

The full text of the Resolution is included in the Notice of General Meeting, which is set out in Part 8 of this document.

You will find enclosed with this document a Form of Proxy for use at the General Meeting. **Whether or not you intend to be present at the General Meeting in person, it is important that you complete and return the Form of Proxy in accordance with the instructions printed on it to Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom, so as to arrive no later than 3:00 p.m. on 26 January 2015.** Completion and return of the Form of Proxy will not preclude you from attending the General Meeting in person, if you so wish and are entitled.

You may also submit your proxies electronically using your investor code detailed on the Form of Proxy. If you hold shares in CREST, you may appoint a proxy by completing and transmitting a CREST Proxy Instruction to CREST ID RA19 so that it is received by no later than 3:00 p.m. on 26 January 2015.

## 12. Further information

Your attention is drawn to the further information set out in **Part 6** of this document. **Shareholders should read the whole of this document and not just rely on the summarised information set out in this letter.**



### **13. Recommendation**

**The Board considers that the Acquisition and the Resolution are in the best interests of the Shareholders as a whole. Accordingly, the Board unanimously recommends that Shareholders vote in favour of the Resolution to be put to the General Meeting, as all Directors intend to do in relation to their own beneficial shareholdings, which in aggregate amount to 226,498 Ordinary Shares, representing approximately 0.0237 per cent. of the total number of voting rights in the Company as at the Effective Date.**

The Board has received financial advice from Credit Suisse and Goldman Sachs in relation to the Acquisition. In providing their financial advice to the Board, each of Credit Suisse and Goldman Sachs have taken into account the commercial assessment of the Board.

Yours faithfully

for and on behalf of Imperial Tobacco Group PLC

Mark Williamson

*Chairman*

## PART 3

### RISK FACTORS

*This Part 3 addresses the risks known to the Company and the Directors which are material risk factors to the proposed Acquisition, will be material risk factors to the Enlarged Group as a result of the proposed Acquisition, or are existing material risk factors to the Imperial Group which will be impacted by the proposed Acquisition. The risk factors included are risks which could materially and adversely affect the business, results of operations, financial condition, turnover, profits, assets and prospects of the Imperial Group and/or the Enlarged Group as appropriate to the detriment of the Imperial Group, the Acquired Assets, the Enlarged Group and/or the Shareholders. In such cases, the market price of the Ordinary Shares may decline and investors may lose all or part of their investment. Prior to voting on the Resolution, Shareholders should consider these risks fully and carefully, together with all other information set out in this document.*

*Additional risks and uncertainties currently unknown to the Company and the Directors, or which the Company and the Directors currently deem immaterial or deem material to the Imperial Group but which will not result from or be impacted by the proposed Acquisition, may also have an adverse effect on the business, financial condition, operating results or prospects of the Imperial Group, the Acquired Assets and the Enlarged Group. In such cases, the market price of the Ordinary Shares may decline and investors may lose all or part of their investment.*

#### 1. RISKS RELATED TO, RESULTING FROM OR IMPACTED BY THE ACQUISITION

##### *Completion of the Acquisition is conditional and the conditions may not be satisfied*

Completion of the Acquisition is conditional upon the satisfaction of certain conditions, further details of which are set out in Part 4 of this document.

There can be no assurance as to the timing of the expiration or termination of the waiting period under the HSR Act with respect to the Merger (or, if applicable, the Acquisition), and therefore the timing of completion of the Acquisition. At any time, any of the DOJ, the FTC, or any State or private person may take action under antitrust laws as it deems necessary or desirable in the public interest, including, without limitation, seeking to enjoin the completion of the Merger or the Acquisition, permitting completion subject to conditions or the divestiture of the businesses acquired as a result of the Merger or the Acquisition. There can be no assurances that any such conditions or such divestiture would be those that Reynolds is obligated to accept or make under the terms of the Merger Agreement. There can be no assurance that a challenge by the DOJ, the FTC, any State or private person to the Merger or the Acquisition under the antitrust laws will not be made, or, if such a challenge is made, that it will not succeed.

There can be no assurance as to the timing of other necessary regulatory and judicial clearance processes, or that such clearances will not be subject to conditions, requirements, limitations or costs, including the giving of certain undertakings by the Imperial Group, to the extent required by the Asset Purchase Agreement. These regulatory conditions, requirements, limitations, costs or undertakings could jeopardise or delay the consummation of the Acquisition or may reduce the anticipated benefits of the proposed acquisition of the Acquired Assets to the Enlarged Group. This may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group, including in each case the share price of Imperial.

In addition, completion of the Acquisition is conditional on the completion of the Merger and there can be no assurance as to the timing of such completion, or that the Merger will be completed in accordance with the terms of the Merger Agreement.

Further details in relation to the Acquisition conditions are set out in Part 4 of this document. There can be no assurance that these conditions will be satisfied (or waived, if applicable). If these conditions are not satisfied or waived, the Acquisition will not take effect, either at all or in the manner currently envisaged.

##### *Delay between signing and completion*

During the period prior to completion of the Acquisition, events or developments may occur, including a reduction in demand or decline in market share of the Brands at a higher rate than anticipated by the Company, which could make the terms of the Asset Purchase Agreement less attractive for the Imperial Group and this may have an adverse effect on the revenue, profits,

business, financial condition or results of the Enlarged Group. Any delay in completion could also result in additional transaction costs and a delay and/or a reduction in the realisation of the anticipated benefits of the Acquisition.

***Requirement for assumption of obligations under the MSA and other State settlements in connection with the acquisition of the Acquired Tobacco Cigarette Brands***

As part of the Acquisition, ITG Brands has agreed to assume the obligations of an OPM with respect to the Acquired Tobacco Cigarette Brands under the MSA and, as a result, will make OPM payments with respect to these brands with certain limited exceptions. ITG Brands has also agreed to use its reasonable best efforts to reach agreements to assume the obligations of an OPM under the Initial State Settlements in respect of the Acquired Tobacco Cigarette Brands with certain limited exceptions. These matters are described in more detail below. It is anticipated that the current brands sold by Commonwealth Brands and ITG Brands will continue to be treated as SPM brands under the MSA after completion of the Acquisition (including retaining the benefit of the ‘grandfathered share’, which is an exemption to payment available to certain SPMs on that portion of market share they had when they joined the MSA).

The nature and extent of payment and other obligations for the Acquired Tobacco Cigarette Brands and the current brands sold by Commonwealth Brands and ITG Brands under the MSA and the other State Settlements Agreements cannot be predicted with certainty, and there can be no assurance that any such treatment will not have an adverse effect on the Imperial Group’s revenue, profits, business, financial condition or results and those of the Enlarged Group.

***Background***

In 1998, Lorillard Tobacco, Philip Morris Incorporated, Brown & Williamson Tobacco Corporation and R.J. Tobacco (the **Original Participating Manufacturers** or **OPMs**) entered the MSA to settle asserted and unasserted health care cost recovery and other claims of those States which were a party to the MSA (the **Settling States**). The OPMs had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the **Initial State Settlements** and, together with the MSA, are referred to as the **State Settlement Agreements**). The State Settlement Agreements provide that the agreements are not admissions, concessions or evidence of any liability or wrongdoing on the part of any party, and were entered into by the OPMs to avoid the further expense, inconvenience, burden and uncertainty of litigation.

Smaller companies were also permitted to join the MSA as **Subsequent Participating Manufacturers** (or **SPMs**) even though they had not been party to the original action by the States. Commonwealth Brands became an SPM in 1998, with SEITA and ITG Brands becoming SPMs in 1999. In November 2007, the Imperial Group received confirmation that the application of Imperial and of several affiliated companies to become SPMs to the MSA had been approved.

The State Settlement Agreements require that the OPMs make annual payments of US\$10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs’ attorneys’ fees, subject to an annual cap of US\$500 million, and were required to pay an additional amount of up to US\$125 million in each year through 2008. The portion of ongoing adjusted settlement payments and legal fees to be paid by each OPM is based on its relative share of domestic cigarette shipments in the year preceding that in which the payment is due. These payment obligations are the several and not joint obligations of each OPM. The State Settlement Agreements also include provisions relating to significant advertising and marketing restrictions, public disclosure of certain industry documents, limitations on challenges to tobacco control and underage use laws, and other provisions.

From time to time, lawsuits have been brought against participating manufacturers to the MSA, or against one or more of the Settling States, challenging the validity of the MSA and/or statutes related to it on certain grounds, including as a violation of the antitrust laws.

In addition, in connection with the MSA, the OPMs entered into an agreement to establish a US\$5.2 billion trust fund payable between 1999 and 2010 to compensate the tobacco growing communities in 14 states (the **Trust**). Payments to the Trust ended in 2005 as a result of an assessment imposed under a federal law, enacted in 2004, repealing the federal supply management program for tobacco growers. Under the law, tobacco quota holders and growers

will be compensated over 10 years with payments totalling US\$10.1 billion, funded by an assessment on tobacco manufacturers and importers. Payments under the law to qualifying tobacco quota holders and growers commenced in 2005 and completed in 2014.

***There is no certainty of timing or satisfaction of regulatory and judicial clearance processes required in connection with the Acquisition, which could prevent the Acquisition from completing in its current form or at all***

#### *DOJ case*

RJR Tobacco and Lorillard Tobacco are parties to a suit by the DOJ in U.S. federal court alleging among other things violations of the U.S. Racketeer Influenced and Corrupt Organizations Act. That litigation resulted in a Final Judgment and Remedial Order dated 18 August 2006, which subjects RJR Tobacco and Lorillard Tobacco to certain conduct restrictions and imposes certain affirmative obligations, including the publication of “corrective statements” in newspaper advertisements, on pack inserts and on any websites dedicated to promoting or advertising any of the Acquired Tobacco Cigarette Brands. Certain terms of that order are currently subject to appeal.

In order to transfer the Acquired Tobacco Cigarette Brands, the court order requires that before the transfer, the acquirer must, after a determination that the acquirer has the capacity to comply with the order, submit to the jurisdiction of the court and be subjected to the obligations of the order. This will involve seeking formal court approval of ITG Brands as the purchaser of the Acquired Tobacco Cigarette Brands and there is uncertainty as to the scope of obligations that ITG Brands will be required to assume under the order. There may also be objections from other parties to the case relating to the obligations that ITG Brands will be required to assume under the order. There can be no assurance that this process will be satisfied in accordance with the Asset Purchase Agreement and, if this is not satisfied, the Acquisition will not take effect, either at all or in the manner currently envisaged.

#### *State certifications*

In addition, the States which are a party to the MSA have passed statutes requiring tobacco cigarette brands to be “certified” (approved for sale) by each State before they can be sold in that State. Each State will therefore have to re-certify the Acquired Tobacco Cigarette Brands in order for ITG Brands to sell them in that State. If this re-certification process is still pending in any State after completion, Reynolds has agreed to distribute the Acquired Tobacco Cigarette Brands under their existing certifications for a transitional period after completion of the Acquisition, and has further agreed to cooperate with ITG Brands and use its reasonable best efforts to ensure that the Acquired Tobacco Cigarette Brands are continuously certified for sale in the States. If any of the States do not re-certify the Acquired Tobacco Cigarette Brands, ITG Brands will not be able to sell the Acquired Tobacco Cigarette Brands in those States.

#### *FDA regulation*

In 2009 the FSPTC Act granted the FDA authority to regulate all tobacco products with immediate effect on cigarettes and smokeless tobacco products. One of the provisions of the FSPTC Act required all U.S. cigarette manufacturers to file ‘Substantial Equivalence’ reports on products in the market place as of 22 March 2011, which were either introduced or changed since 15 February 2007. The FDA refers to these reports, filed as of March 2011, as “provisional” Substantial Equivalence reports. Along with other companies, Reynolds has indicated that it has complied with the FDA’s requirements by filing provisional Substantial Equivalence reports regarding the Acquired Tobacco Cigarette Brands. The FDA has not yet approved any of the provisional Substantial Equivalence reports which were filed, including those for Reynolds. It is anticipated that these reports will be approved, and Reynolds has agreed to cooperate in the transfer of these reports to ITG Brands, and in obtaining FDA approval. Lorillard has indicated that it filed provisional Substantial Equivalence reports on or before the 22 March 2011 deadline as required by the FSPTC Act. In addition, Lorillard has indicated that it filed regular Substantial Equivalence reports for new products and in 2013 received regular Substantial Equivalence orders approving two new products it introduced later that year.

Finally, the transfer of the manufacture of the *Winston*, *Kool* and *Salem* brands and, in certain circumstances, the *Doral* brand to Imperial’s manufacturing facilities and the transfer of the manufacture of the *Newport* brand to Reynolds’ manufacturing facilities (and accordingly, the

cessation of the requirement for the Reciprocal Manufacturing Agreement), will in each case require that the parties be able to duplicate the products in their own facilities. Failure to do so could require Substantial Equivalence approval as per the above. This migration process could take longer than expected and result in prolonging the duration of the contract manufacturing arrangement.

There can be no assurance as to the timing or completion of such FDA approvals, transfer of manufacture or the re-certification of the Acquired Tobacco Cigarette Brands for sale by ITG Brands in the States, or that such transfers or re-certification will not be subject to conditions, requirements, limitations or costs, including the giving of certain undertakings by the Imperial Group. Moreover, if States with 5 per cent. or more of the MSA Allocable Share have indicated in writing that they will not certify or will de-list the Acquired Tobacco Cigarette Brands, the Acquisition may not take effect, either at all or in the manner currently envisaged. These regulatory conditions, requirements, limitations, costs or undertakings may also reduce the anticipated benefits of the proposed acquisition of the Acquired Assets to the Enlarged Group, and any such matters (or delay in, or failure of, the transfer or recertification process) may adversely affect the cost synergies and operational efficiency improvements anticipated by the Imperial Group to be achieved from the Acquisition, which may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Company may not realise the expected tax benefits of the Acquisition for the Enlarged Group to the extent envisaged, or at all***

The Company expects to generate tax benefits equal to a present value of approximately US\$1.5 billion following completion of the Acquisition. The expected benefits are derived on the basis of an assumed purchase price post certain adjustments, and after deducting the expected book value of the fixed assets and other intangible assets to be acquired which are not intended to be held within the U.S. tax group of the Imperial Group after completion of the Acquisition, to derive the book value of the intangible assets to be held within the U.S. tax group of the Imperial Group. The fair value of the intangible assets and purchase price allocation is to be determined post-completion of the Acquisition. It is assumed that these will be fully amortised on a straight-line basis over 15 years. The annual amortisation charge is assumed to be fully deductible for U.S. tax purposes from the annual taxable profits realised over the 15 year period against an assumed effective U.S. tax rate of 39 per cent. This benefit was then discounted at 7 per cent.

There is a risk that changes to relevant legislation, regulation or practice may occur following completion of the Acquisition, which may result, *inter alia*, in a lowering of U.S. tax rates thereby reducing the value of the assumed tax benefit. Such changes or changes to accounting policies, practices or conventions could also mean there is a risk that the Enlarged Group may not be permitted to amortise the expected tax benefits to the extent currently envisaged by the Company.

Additionally, there can be no assurance that the enlarged U.S. business of the Imperial Group generates a taxable profit in each or any financial year, from which the annual amortisation charge can be fully deducted for U.S. tax purposes. This may prevent the Company from generating some or all of the expected tax benefit.

Furthermore, the Company's assumptions regarding the purchase price allocation and fair value of the intangible assets may be revised on the basis of further work pre- or post-completion of the Acquisition. If the tax benefits do not prove to be in line with the Company's expectations or cannot be generated partially or in full following the Acquisition, this may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

**2. NEW RISKS RELATED TO THE IMPERIAL GROUP'S BUSINESS AS RELATED TO, RESULTING FROM OR IMPACTED BY THE ACQUISITION**

***In implementing the strategy for the enlarged U.S. business, the Enlarged Group may fail to achieve the expectations of the Company, the Acquired Assets may not perform in line with expectations, and/or the integration of the Acquired Assets could result in operating inefficiencies and other adverse consequences***

Assuming the Acquisition completes, the results of the subsequent implementation of the strategy for the enlarged U.S. business of the Imperial Group may differ from the expectations of the Company, the Enlarged Group may not achieve the expected outcomes of this strategy



and may fail to perform in line with the expectations of the Company. The implementation of this strategy and the integration of the Acquired Assets may create unforeseen operating inefficiencies and expenditures which pose management, administrative and financial challenges. The integration of the Acquired Assets may be potentially complex and require significant time and effort on the part of the Imperial Group and the Enlarged Group, and resources may be diverted away from core business activities as personnel may be required to assist in the integration process. This integration process may take longer than expected, or difficulties relating to the integration, of which the Directors are not yet aware, may arise. These difficulties and other adverse consequences may include the discovery of potential liabilities, or other problems arising from the contracts and other assets related to the Acquired Assets acquired by the Imperial Group, which were not apparent to the Imperial Group from its legal, commercial and financial due diligence. There may also be unforeseen disruptions or failures to the operating or IT systems of the Enlarged Group during this integration which could significantly limit the Enlarged Group's ability to manage and operate its business efficiently, and may lead to delays, a loss in sales or increased costs.

Further, there may be challenges associated with the implementation of transitional services in connection with the Acquisition. These may have an adverse effect on the operations, revenue, profits, business, financial condition or results of the Enlarged Group.

Additionally, if the results of the implementation of the strategy for the Enlarged Group and the results and cash flows generated by the combination of the operations of the Acquired Assets with those of the Imperial Group are not in line with the Directors' expectations this may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group. In certain circumstances, a write-down may also be required against the carrying value of the Imperial Group's investment in the Acquired Assets. Such a write-down may reduce the Enlarged Group's ability to generate distributable reserves and consequently affect its ability to pay dividends or return capital to Shareholders or otherwise have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***The Imperial Group may need to rely on certain key individuals of the Enlarged Group in the U.S. to integrate the Acquired Assets***

The future success of the Enlarged Group will, in part, be dependent upon the successful integration, retention and motivation of key members of the Enlarged Group's management and staff in the U.S. Failure to identify and retain key individuals following completion of the Acquisition may affect the Imperial Group's ability to successfully integrate the Acquired Assets into the Enlarged Group. This may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***There will be continued interdependence between the Reynolds Group and the Enlarged Group for the manufacture of certain cigarette brands after completion of the Acquisition***

Following completion of the Acquisition, and during a transition period until manufacture of the relevant Brands is transferred to a manufacturing facility of the Enlarged Group, the Enlarged Group will be dependent on the Reynolds Group for the manufacture of the *Winston*, *Kool* and *Salem* brands and, in certain circumstances, the *Doral* brand as the Reynolds Group is retaining the factory at Tobaccoville which produces these brands. If the Reynolds Group suffers business, financial or operational difficulties, or suffers other problems which impede its ability to meet its obligations to the Enlarged Group following completion of the Asset Purchase Agreement, this could result in the Enlarged Group being unable to supply the *Winston*, *Kool* and/or *Salem* brands and/or, in certain circumstance, the *Doral* brand in adequate quantities to meet market demand or at all, which may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

Further, following completion of the Acquisition, and during a transition period until manufacture of the *Newport* brand is transferred to a manufacturing facility of the Reynolds Group, the Enlarged Group will be manufacturing the *Newport* brand for the Reynolds Group as the Imperial Group is acquiring the Greensboro factory where this brand is currently manufactured. If the Enlarged Group suffers business, financial or operational difficulties, or suffers other problems which impede its ability to meet its obligations to the Reynolds Group following completion of the Asset Purchase Agreement, this could result in the Enlarged Group being unable to supply the *Newport* brand in adequate quantities to meet market demand or at all, which could expose the Enlarged Group to a claim under the Reciprocal Manufacturing

Agreement between ITG Brands and RJR Tobacco in connection with the Asset Purchase Agreement. This may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***As several of the Acquired Tobacco Cigarette Brands are menthol brands or include menthol products, the Enlarged Group may be adversely affected by U.S. regulation of menthol in cigarettes***

As two of the Acquired Tobacco Cigarette Brands are menthol brands (*Kool* and *Salem*) and another of the Acquired Tobacco Cigarette Brands has menthol products (*Maverick*), any future FDA regulation of menthol in cigarettes or public concerns that menthol cigarettes may pose greater health risks than non-menthol cigarettes may adversely affect the revenue, profits, business, financial condition or results of the Enlarged Group.

***Background***

Plaintiffs in various U.S. claims, as well as the FDA and other public health agencies, have claimed or expressed concerns that menthol cigarettes may pose greater health risks and may impact public health more than non-menthol cigarettes, including concerns that menthol cigarettes may make it easier to start smoking and harder to quit.

Following the FSPTC Act in 2009, the FDA established the Tobacco Products Scientific Advisory Committee (the **TPSAC**) to evaluate, among other things, “the impact of the use of menthol in cigarettes on the public health, including such use among children, African-Americans, Hispanics, and other racial and ethnic minorities”. In addition, the FSPTC Act permits the FDA to impose restrictions regarding the use of menthol in cigarettes, including a ban, if those restrictions would be appropriate for the public health. The findings of the TPSAC report, which is not binding on the FDA, included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and that consumers continue to believe that smoking menthol cigarettes is less harmful than smoking non-menthol cigarettes as a result of the cigarette industry’s historical marketing. TPSAC’s overall recommendation to the FDA was that “[r]emoval of menthol cigarettes from the marketplace would benefit public health in the United States”.

On 27 June 2011, the FDA provided a progress report on its review of the science related to menthol cigarettes. In this report the FDA stated that “[e]xperts within the FDA Center for Tobacco Products are conducting an independent review of the science related to the impact of menthol in cigarettes on public health...” The FDA stated that it would submit its draft independent review of menthol science to an external peer review panel in July 2011. On 26 January 2012, the FDA provided a second progress report on its review of the science related to menthol cigarettes. In this update, the FDA stated that “FDA submitted its report to external scientists for peer review, and the agency is revising its report based on their feedback”.

On 24 July 2013, the FDA made available its preliminary scientific evaluation (**PSE**) of public health issues related to the use of menthol in cigarettes and peer review comments thereto. Although the FDA PSE found that menthol in cigarettes is not associated with increased smoke toxicity, increased levels of biomarkers of exposure or increased disease risk, the evaluation concluded that menthol in cigarettes is likely associated with increased initiation and progression to regular cigarette smoking, increased dependence, reduced success of smoking cessation, especially among African-American menthol smokers, altered physiological responses to tobacco smoke and particular patterns of smoking. In the PSE, the FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. The FDA also issued an Advance Notice of Proposed Rulemaking (**ANPRM**) seeking comments on the PSE and requesting additional information related to potential regulatory options it might consider for the regulation of menthol. The FDA has sought comments regarding, among other things, information on potential product standards for levels of menthol in cigarettes; the timeframe for compliance with any product standard enacted; whether a stepped approach to lowering or removing menthol from cigarettes would be appropriate; whether sales, distribution, advertising or promotion restrictions are appropriate; and evidence, including public health impact, of any potential illicit market in menthol cigarettes should they no longer be available. In addition, the FDA announced that it is funding new research on, among other things, the differences between menthol and non-menthol cigarettes to obtain information to assist FDA in making informed decisions related to potential regulation of menthol in cigarettes. The FDA



established a comment period, which ended on 22 November 2013, for the ANPRM and PSE, and said it will consider all comments and other information submitted to determine what, if any, regulatory action is appropriate. If the FDA determines that regulation of menthol is warranted, the FDA could promulgate regulations that, among other things, could result in a ban on, or restrictions on the use of, menthol in cigarettes, or further restrictions on the marketing and advertising of menthol cigarettes. The timing of the release of any such proposed regulation remains uncertain.

Following completion of the Acquisition of the Acquired Tobacco Cigarette Brands, the Enlarged Group could face increased exposure to tobacco-related litigation as a result of such findings. Even if such claims are unsubstantiated, increased concerns about the health impact of menthol cigarettes could adversely affect sales of the Acquired Tobacco Cigarette Brands. Any ban or limitation on the use of menthol in cigarettes by the FDA could have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***As one of the Brands being acquired is the blu Brand, the Enlarged Group may be adversely affected by regulation of e-cigarettes***

On 25 April 2014, the FDA published the draft deeming regulations (the **Draft Regulation**) which propose to bring all remaining tobacco products (including e-cigarettes) under the FSPTC Act. The Draft Regulation is subject to a public comment period, which closed on 8 August 2014. To date approximately 82,000 such comments have been received by the FDA. As part of the final rule making process, the FDA is required to consider such comments. The products that are “deemed” to be covered by the FSPTC Act as a result of the final regulation will be subject to, among other things, minimum age restrictions, health warning requirements, and a requirement to register product and ingredient information with the FDA. The final regulation is expected to also require all such products introduced into commerce after 15 February 2007, to be subject to FDA pre-market approval. The result of the regulation will likely be that all e-cigarettes placed on the market after that date will need to be reviewed by the FDA, although products on the market as of the effective date of the regulation will be allowed to remain in the market pending FDA review (please see the section below, “*The Enlarged Group may be adversely affected by further regulation by the FDA*”, in respect of potential FDA regulation).

It is not possible to predict the scope of such regulations (or any other regulation of e-cigarettes that may be proposed or implemented by other regulatory authorities) or the impact any such regulations may have on the e-cigarette business, though, if enacted, they may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group, in particular given one of the acquired Brands is *blu* which is a leading e-cigarette brand in the U.S.

***The Imperial Group and the Enlarged Group may be subject to investigation for alleged abuse of their market position in the U.S. and certain other countries***

The Imperial Group has significant market positions in certain countries in which it operates, including the U.K., Germany, France, Spain and Morocco and, following completion of the Acquisition, the Enlarged Group will have a significant position in the U.S. The Imperial Group and the Enlarged Group is from time to time and may in the future be subject to investigation for alleged abuse of its market position or other alleged breaches of competition laws, which can result in adverse regulatory action by the relevant authorities, including inspections, whether unannounced or otherwise, monetary fines and negative publicity. While the Imperial Group complies with all applicable laws and co-operates with all ongoing investigations, whether concerning antitrust matters or otherwise, there can be no assurances that, in the future, any investigation to which the Enlarged Group is subject will not result in actions being brought against members of the Enlarged Group or that any such investigations or publicity will not have an adverse effect on the Imperial Group’s revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Enlarged Group will have greater exposure to foreign exchange rate risk***

Imperial reports its financial results in pounds sterling while the Acquired Assets trade in U.S. dollars. The Enlarged Group will therefore be exposed to greater movements in foreign exchange rates, in particular in respect of U.S. dollars, due to the increase in size, following completion of the Acquisition, of the Imperial Group’s foreign subsidiaries, their commercial trading transactions denominated in foreign currencies and foreign currency cash deposits, borrowings

and derivatives. This means that if the Acquisition completes and the U.S. dollar appreciates against the pound sterling, such appreciation will increase the sterling equivalent value of the total investment and the cash flow generated by the Acquired Assets as reported in Imperial's accounts. Conversely, if the Acquisition proceeds and the U.S. dollar depreciates against the pound sterling, such depreciation will decrease the sterling equivalent value of the total investment and the cash flow generated by the Acquired Assets as reported in Imperial's accounts.

For the year ended 30 September 2014, 82 per cent. of the Imperial Group's revenue (year ended 30 September 2013: 82 per cent.) was generated in markets outside the United Kingdom. This revenue percentage will increase following completion of the Acquisition. Certain sales in these markets are invoiced in currencies other than the functional currency of the selling company.

As a result of the Acquisition the Enlarged Group will be subject to an increased translation of the results of overseas subsidiaries into pounds sterling, as well as to the impact of increased trading transactions in foreign currencies, compared to what the Imperial Group is currently exposed to. Significant fluctuations in foreign exchange rates may therefore have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group which is greater than that which the Imperial Group may currently be exposed to as at the date of this document.

***The Enlarged Group will have greater exposure to interest rate fluctuations***

The Imperial Group is, and the Enlarged Group will be, exposed to fluctuations in interest rates on its borrowings and surplus cash balances. The most material risk is in respect of borrowings which will increase as a result of the Acquisition. Although approximately 50 per cent. of the Imperial Group's reported net debt (after adjusting for the effect of interest rate derivatives) outstanding as at 30 September 2014 was at fixed levels of interest, the Imperial Group is still exposed to movements in interest rates which could result in higher cash outflows, reducing the capital available to the Imperial Group. As at 30 September 2014, the Imperial Group had reported net debt of £8,549 million. Of this, approximately 17 per cent. was denominated in pounds sterling, 73 per cent. in euro and 10 per cent. in U.S. dollars. Accordingly, the Imperial Group's financial results are currently mainly exposed to gains or losses arising from fluctuations in interest rates relating to pounds sterling, euro and U.S. dollars. Significant fluctuations in interest rates may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. In order to finance the Acquisition further bank facilities have been entered into which provide facilities denominated in U.S. dollars, Euros and pound sterling. The Enlarged Group will therefore have greater exposure to significant fluctuations in interest rates which may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***The Imperial Group has, and the Enlarged Group will have, significant borrowings, which will be materially increased as a result of completion of the Acquisition and which may impair operational and financial flexibility***

The Imperial Group has, and the Enlarged Group will have, a significant amount of indebtedness and debt service obligations, which may impair both the Imperial Group's operating and financial flexibility and that of the Enlarged Group and could adversely affect the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. Limited ability to borrow additional funds may reduce both the Imperial Group's and the Enlarged Group's flexibility in reacting to competitive or industry pressures or opportunities.

As at 30 September 2014, the Imperial Group had reported net debt of £8,549 million (as at 30 September 2013: £9,518 million).

In connection with the Acquisition, committed bank facilities of US\$7.1 billion are available to the Imperial Group under the Facilities Agreement. It is proposed that these facilities will be used to finance the Acquisition. Additionally, under the Facilities Agreement, committed bank facilities of €3,835 million and £500 million are made available to the Imperial Group to refinance certain of the Imperial Group's existing bank facilities and indebtedness under debt capital markets issuances, and to provide working capital for the Enlarged Group and to finance the payment of fees and expenses related to the Acquisition. The Imperial Group's and the

Enlarged Group's substantial indebtedness could potentially cause the Imperial Group and the Enlarged Group to dedicate a significant portion of cash flow from operations to payments to service debt, depending on the level of borrowings, prevailing interest rates and exchange rate fluctuations, which would reduce the funds available to the Imperial Group and the Enlarged Group for discretionary capital expenditure, acquisitions and other discretionary expenditure. The Imperial Group's and the Enlarged Group's indebtedness could also limit its ability to borrow additional funds for discretionary capital expenditure, acquisitions and other discretionary expenditure; limit flexibility in planning for, or reacting to, changes in technology, customer demand, competitive pressures and the industry in which the Imperial Group and the Enlarged Group operate; place the Imperial Group and the Enlarged Group at a competitive disadvantage compared to its competitors that are currently less leveraged than the Imperial Group is and the Enlarged Group will be; and increase the Imperial Group's and the Enlarged Group's vulnerability to both general and industry-specific adverse economic conditions and this may have an adverse effect on the revenue, profits, business, financial conditions or results of the Enlarged Group.

The Imperial Group's and the Enlarged Group's debt facilities will, as is usual for debt facilities of such nature, contain a number of financial, operating and other obligations that may limit their operating and financial flexibility.

***Following the entry into the borrowing arrangements for the Acquisition, the Imperial Group and the Enlarged Group may find it difficult to obtain new financing or new financing may be at higher costs and a downgrade in any of the Imperial Group's and the Enlarged Group's credit ratings could increase this risk***

The Imperial Group currently uses, and the Enlarged Group will use, funds made available through various sources of financing, primarily issuances of capital markets debt, bank loan financing and euro commercial paper (ECP). Further borrowing arrangements have also been entered into by the Imperial Group in connection with the Acquisition as set out above. Access to financing in the future will depend on, among other things, suitable market conditions and the maintenance of suitable long-term and short-term credit ratings. The Imperial Group's and the Enlarged Group's credit ratings may be adversely affected by various factors, including increased debt levels, decreased earnings, decreased customer demand, increased regulation, deterioration in general economic conditions, deterioration in business conditions and adverse publicity. If conditions in credit markets are unfavourable and/or the Imperial Group's and the Enlarged Group's credit ratings are downgraded the Imperial Group and the Enlarged Group may not be able to obtain new sources of financing and/or such new sources of financing, together with the Imperial Group and the Enlarged Group's existing financing sources, may be at higher costs. Furthermore, the Imperial Group and the Enlarged Group may be unable to refinance their debt, when it matures, in the debt capital markets, bank loan markets or ECP market. In addition, the cost of refinancing the debt, prior to maturity or when it matures, may be materially higher than the current cost. These events may adversely affect the Imperial Group's and the Enlarged Group's borrowing costs and may therefore adversely affect the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Greensboro factory and certain other storage and office facilities which are Acquired Assets could be affected by environmental and health and safety liabilities***

The Enlarged Group will acquire Lorillard's manufacturing and office facilities in Greensboro, North Carolina, and certain other storage and office facilities. The Enlarged Group may acquire or incur liabilities associated with such properties under environmental and health and safety laws. Such liabilities may, for example, relate to past, present or future liabilities for breaches of environmental and health and safety laws, land contamination and associated clean-up costs, injuries or illnesses to workers or other persons present at the factory and/or liabilities associated with the presence of hazardous substances such as asbestos. Such liabilities may include civil or criminal penalties as well as claims from third parties and may result in significant costs or liabilities to the Enlarged Group which may adversely affect the revenue, profits, business, financial condition or results of the Enlarged Group.

### 3. EXISTING RISKS RELATED TO THE IMPERIAL GROUP'S BUSINESS AS RELATED TO, RESULTING FROM OR IMPACTED BY THE ACQUISITION

#### ***Increased regulation of the tobacco industry may have an adverse effect on the demand for tobacco products or may increase compliance costs***

The advertising, sale and consumption of tobacco products have been subject to regulatory influence from governments, health officials and anti-smoking groups, principally due to their conclusion that cigarette smoking and tobacco products are harmful to health. This has resulted in substantial restrictions on the manufacture, development, testing, content, sale, distribution, packaging, labelling, display, marketing, advertising, product design and consumption of tobacco products, including limitations on where tobacco products can be used or smoked. These restrictions have been introduced by both regulation and voluntary agreements. In addition, anti-smoking groups continue to advocate the exclusion of the industry from consultation processes and seek to diminish the social acceptability of smoking. Anti-smoking groups are pursuing this agenda through petitioning, *inter alia*, individual governments and the World Health Organisation.

Regulatory initiatives affecting the tobacco industry that have been proposed, introduced or enacted include: restrictions or bans on advertising, marketing and sponsorship; the display of larger health warnings, graphic health warnings and other labelling requirements on tobacco product packaging and restrictions on packaging design, including the use of colours and plain packaging; restrictions on pack content, including minimum quantity per pack; restrictions or bans on the display of tobacco product packaging at the point of sale and restrictions or bans on cigarette vending machines; restrictions on the types of retail outlet that are permitted to sell tobacco products; requirements regarding testing, verification and limits for tar, nicotine, carbon monoxide and other smoke constituent levels; requirements regarding reporting, evaluation and possible bans of certain tobacco product ingredients; requirements that products meet safety standards for ignition propensity; increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors; implementation of measures restricting descriptive terms which might be argued to create an impression that one brand of cigarettes is less harmful than another; and requirements for the 'track and trace' of tobacco products to retail level. The Imperial Group, along with all other tobacco manufacturers, is sometimes excluded from consultation with regulators on these regulatory proposals. The U.S. is a very heavily regulated environment with regulation at both the federal and State level and there is therefore a risk that either federal or State regulation or both may become materially more intrusive or adverse. Any future increases in the regulation of the tobacco industry in the U.S. could result in a substantial decline in the demand for tobacco products (including, in the case of restrictions or bans on packaging, in the ability of the consumers to differentiate brands) or in an increase in the costs of the Enlarged Group in complying with these regulatory requirements, or require manufacturers to review and adapt their product portfolio as a result of restrictions or bans, either by way of developing innovative products or offers in other categories. Each of these may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group and could contribute to an increase in the illicit trade in tobacco products.

In addition to the general regulatory factors set out above, the Enlarged Group may also be impacted by further specific regulatory actions and initiatives in the U.S. and in more specific industry sectors as set out in the following sections in this Part 3, "*As several of the Acquired Tobacco Cigarette Brands are menthol brands or include menthol products, the Enlarged Group may be adversely affected by U.S. regulation of menthol in cigarettes*", "*The Enlarged Group may be adversely affected by regulation of e-cigarettes*", and "*The Enlarged Group may be adversely affected by further regulation by the FDA*".

#### ***The Enlarged Group may be adversely affected by further regulation by the FDA***

The FSPTC Act of 2009 granted the FDA regulatory authority over all tobacco products with immediate effect over cigarettes, roll your own and smokeless products.

Key elements of the FSPTC Act regulate the annual registration of tobacco companies, product testing and the submission of ingredient information; require FDA approval for all new products, brands or product modifications; ban all characterising artificial or natural flavours other than tobacco or menthol in cigarettes; establish 'user fees' to fund FDA regulation of tobacco products; increase the health warning size on cigarette packs with the option to



introduce pictorial health warnings; provide for implementation of good manufacturing practices; revise the labelling and advertising requirements for smokeless tobacco products; require the investigation of menthol (for further discussion relative to menthol products, please see the section above, *“As several of the Acquired Tobacco Cigarette Brands are menthol brands or include menthol products, the Enlarged Group may be adversely affected by U.S. regulation of menthol in cigarettes”*); and allow the FDA to issue regulations deeming other tobacco products to be subject to the FSPTC Act.

In addition, on 25 April 2014, the FDA published the Draft Regulation which proposed to bring all remaining tobacco products (including cigars and e-cigarettes) under the regulatory authority of the FDA. The Draft Regulation is subject to a public comment period, which closed on 8 August 2014. To date approximately 82,000 such comments have been received by the FDA. As part of the final rule making process, the FDA is required to consider such comments, and a final regulation is not expected until June 2015 or later. These products that are “deemed” to be covered by the FSPTC Act as a result of the final regulation will be subject to, among other things, minimum age restrictions, health warning requirements and a requirement to register product and ingredient information with the FDA. The final regulation is also expected to require that all such products introduced into commerce after 15 February 2007 to be subject to FDA pre-market approval. Because most e-cigarettes were introduced into commerce after that date, the result will be that virtually all e-cigarettes will need to be submitted to the FDA for review, although products on the market as of the effective date of the regulation will be allowed to remain in the market pending FDA review. The final regulation, while expected to include most of the restrictions relating to cigarettes and smokeless tobacco products, may differ in its treatment of newly deemed products (for further discussion relative to e-cigarettes, please see the section above, *“The Enlarged Group may be adversely affected by regulation of e-cigarettes”*, and *“The Enlarged Group may be adversely affected by further regulation by the FDA”* in respect of potential FDA regulation).

The regulations under the FSPTC Act, and any further regulations introduced as part of the final regulation referred to above could result in a substantial decline in the demand for tobacco products (including, in the case of restrictions or bans on packaging, in the ability of the consumers to differentiate brands) or in an increase in the costs of the Enlarged Group in complying with these regulatory requirements, or require manufacturers to review and adapt their product portfolio as a result of restrictions or bans, either by way of developing innovative products or offers in other categories. Each of these may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group. Please see the section above, *“No certainty of timing or satisfaction of regulatory and judicial clearance processes required in connection with the Acquisition”*, for details of the impact of the need for U.S. cigarette manufacturers to file ‘Substantial Equivalence’ reports under the FSPTC Act. In addition, these regulations, including the need for pre-market approvals by the FDA, may limit Imperial’s ability to communicate with consumers, may restrict its ability to participate in the public discussion surrounding its products and may limit its ability to launch new or change existing products. There can be no certainty as to the timing or completion of such approvals, which may have an adverse effect on the future business opportunities, revenue, profits, business, financial condition or results of the Enlarged Group.

***Substantial payment obligations under the MSA and the other State Settlement Agreements, along with State certification requirements, may have an adverse effect on the cash flows and operating income of the Enlarged Group following completion of the Acquisition***

Annual payments under the MSA and the other State Settlement Agreements are required to be paid in perpetuity and are based, among other things, on domestic market share and unit volume, with respect to the MSA, in the year preceding the year in which payment is due, and, with respect to the other State Settlement Agreements for OPM brands, in the year in which payment is due.

Amounts due under the MSA and the other State Settlement Agreements are impacted by a number of factors, including, among others, industry volume, market share and (for OPM brands) industry operating profits. As such, it is possible that any adjustments to volume, market share and industry operating profits may have an adverse effect on the MSA and State Settlement Agreements’ obligations, cash flows, revenue, profits, business, financial condition or results of the Enlarged Group.

In addition, the States which are a party to the MSA have passed statutes requiring tobacco cigarette brands to be “certified” (approved for sale) by each State before they can be sold in that State. The Enlarged Group may be adversely affected by decisions made by any State not to certify or to de-list brands.

***The Imperial Group is, and the Enlarged Group will be, dependent on its positions in its key countries and on key customer relationships***

The continued organic growth of the Imperial Group’s business is underpinned by its positions in a number of key countries, including the United Kingdom, Australia, Germany, France, Spain and Morocco. Upon completion of the Acquisition, the U.S. will be a key country for the Enlarged Group. Any future declines in these markets could have an adverse effect on the Imperial Group’s revenue, profits, business, financial condition or results and those of the Enlarged Group.

The Imperial Group has, and the Enlarged Group following completion of the Acquisition will have, a number of key customers under contractual arrangements which have relatively short durations and termination periods. The loss of any of these key customers could have an adverse effect on the Imperial Group’s revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Imperial Group and the Enlarged Group could incur substantial damages and costs in connection with litigation in the U.S.***

Other than as noted below, before 2007, the Imperial Group had not sold cigarettes in the U.S., the jurisdiction with the greatest prevalence of smoking and health-related litigation. However, three subsidiaries, Reemtsma Cigarettenfabriken GmbH, SEITA and Altadis, sold relatively small quantities of cigarettes and/or fine cut tobacco in the U.S. domestic market up to 1999, up to 2005 and up to 2004 respectively. The Imperial Group currently has limited sales in the U.S. duty free market. In 2007 and 2008 respectively the Imperial Group acquired Commonwealth Brands and ITG Brands, both of which were and are manufacturers and sellers of tobacco products in the U.S., with Commonwealth Brands selling products in the U.S. since the early 1990s.

The Acquired Assets include the Acquired Tobacco Cigarette Brands which are manufactured and primarily sold in the U.S. The Acquired Tobacco Cigarette Brands are to be acquired without historic product liabilities and an indemnity in respect of any liabilities relating to the period prior to completion of the Acquisition will also be provided by Reynolds under the terms of the Acquisition. Please refer to paragraph 2.6 of Part 4 of this document for more information.

The Enlarged Group will be responsible for the Acquired Tobacco Cigarette Brands and the *blu* brand following completion of the Acquisition. It can be expected that legal actions, proceedings and claims arising out of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of cigarettes, whether relating to cigarettes generally or menthol cigarettes, will be filed against the Enlarged Group in the future that relate to the period following completion of the Acquisition (for further discussion relative to menthol products, please see the section above, “*As several of the Acquired Tobacco Cigarette Brands are menthol brands or include menthol products, the Enlarged Group may be adversely affected by U.S. regulation of menthol in cigarettes*”). It is also possible that legal actions, proceedings and claims may be filed against the Enlarged Group in respect of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of the *blu* brand or other e-cigarette or e-vapour products. Additionally, the Enlarged Group’s products may become contaminated, for example, as a result of an accident during the manufacturing process or deliberately with malicious intent.

Such claims could be brought in federal, state or local courts, or by way of enforcement actions, and by individuals, as a class or group action by a number of parties (whether in actions in which a class has been certified or in which plaintiffs are seeking class certification or in which individual cases have been grouped for a consolidated trial), by national or local regulatory authorities or other public institutions, by corporations, unions, funds or other incorporated entities, or by political or social organisations (such as Native American tribes) and the claims

could relate, *inter alia*, to claims for personal injury, addiction or death, costs of providing healthcare (including cost recovery actions) and costs of court-supervised health monitoring programmes.

The damages sought in any such claims could be significant. It can be expected that the Enlarged Group will not be successful in defending all of the claims that may arise. In addition, regardless of the outcome of any litigation, the Enlarged Group will incur costs defending claims which it will not be able to recover fully, irrespective of whether it is successful in defending such claims. Verdicts in favour of plaintiffs in individual actions regarding the health effects of smoking, or the settlement of such cases, whether by the Enlarged Group or by other tobacco companies could also encourage the commencement of new actions and could have adverse effects on the ability of the Enlarged Group to prevail in other smoking and health litigation.

An unfavourable outcome or settlement of any pending or future smoking and health-related or other litigation may have an adverse effect upon the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. There can also be no assurance that legal aid or other funding will continue to be denied to claimants in smoking and health-related or other litigation in any jurisdiction outside the U.S. in the future. If future claimants are able to obtain legal aid or funding to finance their litigation against the Imperial Group and the Enlarged Group, this may increase the number of claims and claimants' likelihood of prevailing on such claims which may have an adverse effect on the Imperial Group's reputation, revenue, profits, business, financial condition or results and those of the Enlarged Group.

A material increase in the number of pending claims could significantly increase the costs and management time for the Enlarged Group to defend such claims. There can be no assurances that any future litigation against the Enlarged Group, if successful, would not have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group. In addition, even if the Enlarged Group is not party to litigation, any adverse judgment against a tobacco manufacturer or in relation to the tobacco market could have an impact on market conditions which may adversely affect the revenue, profits, business, financial condition or results of the Enlarged Group.

To the extent that the Enlarged Group's determinations at any time as to the likely outcome of any claim do not reflect subsequent developments or the eventual outcome of any claim, its future financial statements may be affected, with an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

In addition to smoking and health-related litigation and other judicial matters, the Imperial Group and the Enlarged Group will be subject to regulatory investigations, claims, lawsuits and other proceedings in the ordinary course of its business and operations. The results of these legal proceedings cannot be predicted with certainty, and there can be no assurance that these matters will not have an adverse effect on the Enlarged Group's results of operations in any future period, and a substantial judgment may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***The U.S. Surgeon General has issued reports regarding health risks of cigarette smoking to non-smokers that could result in additional litigation against cigarette manufacturers, additional restrictions placed on cigarette smoking, and additional regulations placed on the manufacture or sale of cigarettes***

In a report entitled "The Health Consequences of Involuntary Exposure to Tobacco Smoke: A Report of the Surgeon General, 2006," the U.S. Surgeon General summarised conclusions from previous Surgeon General's reports concerning health risks to non-smokers from exposure to environmental tobacco smoke, also called second-hand smoke. The Surgeon General also addressed health risks to non-smokers from exposure to environmental tobacco smoke in reports published in 2010 and 2014. These reports could form the basis of or be used to support additional litigation against cigarette manufacturers, including against the Enlarged Group. It is also possible that the Surgeon General's reports could result in additional restrictions being placed on cigarette smoking or in additional regulations being placed on the manufacture or sale of cigarettes which could have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.



***The Imperial Group and the Enlarged Group operate in highly competitive markets***

Following completion of the Acquisition, the Enlarged Group's competitors will include Philip Morris International Inc., British American Tobacco plc, Japan Tobacco Inc., and, in the U.S., Altria Group, the merged Reynolds/Lorillard group, and Liggett Vector Brands LLC. These companies may have greater financial resources than the Imperial Group currently has, and than the Enlarged Group may have following completion of the Acquisition. These companies also remain strong competitors in the markets in which the Imperial Group currently operates, and in which the Enlarged Group will operate after completion of the Acquisition. Significant increases in the competitive activity of these companies or other local manufacturers, in response to the Acquisition or otherwise, could lead to further competition and pricing pressure on the Imperial Group's and the Enlarged Group's brands and reduce the Imperial Group's and the Enlarged Group's profit margins and cash-flows. The Imperial Group's and the Enlarged Group's ability to compete with these companies may be limited by the regulatory environment in which it operates, including advertising restrictions, and this may adversely impact the Imperial Group's and the Enlarged Group's efforts to strengthen its brand portfolio. Actions from the Imperial Group's and the Enlarged Group's competitors may also have an unfavourable impact on the Imperial Group's and the Enlarged Group's ability to meet its strategy of growing the Imperial Group and the Enlarged Group organically and through acquisitions. These may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***Future demand for e-cigarettes and the nature of the e-cigarette market is uncertain***

E-cigarettes, having been recently introduced to market, are at an early stage of development and are evolving rapidly. Competition in the e-cigarette industry is intense. The Imperial Group competes, and the Enlarged Group will compete, with many companies in the market for e-cigarettes and the nature of the Imperial Group's and, following completion of the Acquisition, the Enlarged Group's competitors is varied as the market is highly fragmented. For instance, the Imperial Group's competitors, and, following completion of the Acquisition, the Enlarged Group's competitors will include large companies, such as Philip Morris and RJR Tobacco, as well as smaller companies with similar product offerings. The method of distribution for many competing companies is predominately over the internet, with only a small number of competitors currently having a significant presence at retail. Future sales and any future profits in the Imperial Group's and the Enlarged Group's electronic cigarette business are substantially dependent upon the acceptance and use of electronic cigarettes by adult smokers. The Imperial Group's and the Enlarged Group's ability to generate future sales will be dependent on a number of factors, many of which are beyond its control, including the pricing of competing products, overall demand for its products, changes in consumer preferences, market competition and government regulation. The Imperial Group and the Enlarged Group may not be able to adapt as the electronic cigarette industry and customer demand evolves, whether as a result of regulatory constraints or requirements or a failure to respond in a timely and/or effective manner to new technologies, customer preferences, changing market conditions or new developments in the industry, which may have an adverse effect on the Imperial Group's and the Enlarged Group's electronic cigarette business. This risk will be increased following the Acquisition as one of the acquired Brands is *blu* which is a leading e-cigarette brand in the U.S. This may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***The Imperial Group conducts and the Enlarged Group will conduct business in countries subject to international sanctions***

Some of the countries in which the Imperial Group does, and the Enlarged Group will do, business or with whom it has commercial dealings, such as Syria and Cuba, have been identified by the U.S. State Department as state sponsors of terrorism.

Historically, the Imperial Group's activities in these jurisdictions have been limited principally to selling tobacco products and to purchasing tobacco leaf and have not been material to the Imperial Group's revenue, profits or financial condition. However, the Imperial Group's business in Cuba, from which it had previously only sourced tobacco leaf prior to January 2008, grew as a result of the Imperial Group's acquisition of the Altadis group which has ownership interests in certain joint ventures in Cuba which manufacture, market, distribute and sell cigars manufactured in Cuba.

The Imperial Group seeks to comply fully with international sanctions to the extent they are applicable to the Imperial Group. However, in doing so, it may be restricted in supplying products sourced from certain countries to relevant jurisdictions, by the nationality of the personnel that it involves in these activities or in its sources of funding. In particular, the cigar operations of the Cuban joint ventures could be materially limited by the operation of the United States Cuban Assets Control Regulations and by the United States Cuban Liberty and Democratic Solidarity (Libertad) Act 1996 (commonly known as the Helms-Burton Act). New sanctions or changes in existing sanctions could further restrict or entirely prevent the Imperial Group and the Enlarged Group from doing business in, or from having commercial dealings with, certain jurisdictions, including Cuba, which may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. Given the increased market share and enhanced profile in the U.S. that the Enlarged Group will have following completion of the Acquisition, any international sanctions could impact the Enlarged Group to a greater degree following completion of the Acquisition.

Additionally, the Imperial Group's expansion into developing markets may present more challenging operating environments in which commercial practices may be less developed and of a lower standard than those in which the Imperial Group has historically operated. As such, although the Imperial Group seeks to comply fully with international sanctions to the extent they are applicable to the Imperial Group, and to the extent they will be applicable to the Enlarged Group following completion of the Acquisition, it may be harder to do so in such markets. Furthermore, the Imperial Group and the Enlarged Group may suffer from adverse public reaction or from reputational harm as a result of doing business in, or having commercial dealings through third parties with, countries that have been identified as state sponsors of terrorism by the U.S. State Department, including Syria and Cuba, or that are subject to international sanctions, notwithstanding that the Imperial Group's and the Enlarged Group's activities comply with applicable international sanctions and regardless of the materiality of the Imperial Group's and the Enlarged Group's operations in such countries to its operations or financial condition. Any such reaction may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group and, given the enhanced U.S. profile the Enlarged Group will have following completion of the Acquisition, any adverse public reaction may have a greater impact on the Enlarged Group following completion of the Acquisition.

The Imperial Group's and the Enlarged Group's activities in the countries subject to international sanctions could also restrict the sources of funding available to the Imperial Group and the Enlarged Group. International sanctions may also limit the Imperial Group's and the Enlarged Group's ability to use existing funds to finance its operations in certain countries, which may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Imperial Group and the Enlarged Group may be adversely affected by changes in taxation legislation***

Legislation relating to taxation, duties or levies in the U.S. and in the other countries in which the Enlarged Group will operate may be subject to future changes, which may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

***The Imperial Group's and the Enlarged Group's labour relations or labour unrest may affect operational and financial performance***

The Imperial Group's management believes that all of Imperial Group's operations have, and that all of the Enlarged Group's operations will have, in general, good relations with their employees, employee representatives and unions. However, there can be no assurance that the Imperial Group's and the Enlarged Group's business or operations will not be affected by labour related problems in the future. In addition, there can be no assurance that any deterioration in labour or union relations, or any disputes or work stoppages or other labour related developments (including problems experienced during any consultation procedures or programmes or the introduction of new labour regulations in the U.S.), including as part of the implementation of the Acquisition, will not adversely affect the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***The Imperial Group and the Enlarged Group could fail to attract or retain senior management or other key employees***

The loss of the services of certain key employees, particularly to competitors or other consumer product companies, may have an adverse effect on the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. In addition, management believes that as the Enlarged Group's business develops and expands, the Imperial Group's and the Enlarged Group's future success will depend on its ability to attract and retain highly skilled and qualified personnel, which cannot be guaranteed.

The failure to attract or retain key personnel could significantly impede the Imperial Group's and the Enlarged Group's financial plans, growth, marketing and other objectives and adversely affect the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group. The Imperial Group's and the Enlarged Group's success will depend to a substantial extent on the ability and experience of its senior management.

***Reliance on, and potential inability to attract, retain and develop highly skilled personnel***

The success of the Imperial Group and the Enlarged Group's strategy is dependent on their ability to attract and retain talent and skills, including a qualified sales force, team of engineers and employees with managerial, technical, sales, marketing and information technology support skills. Employee retention may be particularly challenging following acquisitions or divestures, such as the Acquisition, as the Enlarged Group must continue to motivate employees (of both the Imperial Group and the Acquired Assets) and keep them focused on its strategies and goals, which may be particularly difficult due to potential distractions related to integrating the Acquired Assets. Failure to retain or loss of the skills necessary to execute growth plans and deliver key customer programmes may lead to reduced retailer confidence which may adversely affect the Imperial Group's revenue, profits, business, financial condition or results and those of the Enlarged Group.

***Protection of intellectual property rights***

The Imperial Group and the Enlarged Group rely on trademarks, patents, registered designs, copyrights and trade secrets. The Enlarged Group will attempt to protect its intellectual property rights, in the U.K., the U.S. and elsewhere, through a combination of trademarks, patents, registered designs, copyrights and trade secret laws, as well as confidentiality agreements. Failure to obtain or maintain adequate protection of intellectual property rights for any reason may adversely affect the Imperial Group's revenue, profits, business, financial condition or results. Following completion of the Acquisition the Enlarged Group will own the Acquired Brands. This will increase the exposure of the Enlarged Group to potential future claims or litigation in respect of the Acquired Brands given the more litigious nature of the U.S. market, including exposure to injunctive relief or damages granted by courts in respect of such claims, and regardless of the outcome of any current litigation or future claims, the Enlarged Group may incur additional costs in defending its intellectual property and other rights following completion of the Acquisition. An unfavourable outcome or settlement in any current or future litigation may have an adverse effect on the revenue, profits, business, financial condition or results of the Enlarged Group.

## PART 4

### PRINCIPAL TERMS OF THE ACQUISITION

#### 1. Structure of the Acquisition

On 15 July 2014, ITG Brands, Imperial and Reynolds entered into the Asset Purchase Agreement in respect of the Acquisition, pursuant to which the parties have agreed, on the terms and subject to the conditions of that agreement, that ITG Brands (or another member of the Imperial Group) will acquire the Acquired Assets.

The Acquired Assets are to be acquired immediately following the completion of the proposed Merger of Lantern Acquisition Co (a subsidiary of Reynolds) and Lorillard.

ITG Brands and Reynolds, *inter alia*, have entered or will enter into certain additional ancillary agreements as further described in paragraph 4 below.

#### 2. Asset Purchase Agreement

The key terms of the Asset Purchase Agreement are summarised below.

##### 2.1 Scope of Acquired Assets and business

Subject to the terms and conditions of the Asset Purchase Agreement, the assets, rights and obligations to be transferred to ITG Brands will include:

- (a) all intellectual property rights in relation to the *Winston*, *Kool*, *Salem* and *Maverick* brands in the U.S., and all assets, properties, licences, rights, obligations and liabilities primarily related to the distribution of the *Winston*, *Kool* and *Salem* brands in Puerto Rico;
- (b) the *blu* brand business, including all associated assets, properties, licences, rights, obligations and liabilities;
- (c) a percentage of the tobacco leaf inventory of the Lorillard Group representing the *Maverick* brand, and a percentage of the tobacco leaf inventory of the Reynolds Group representing the *Winston*, *Kool* and *Salem* brands, as well as associated work-in-process and inventory relating to the Acquired Assets; and
- (d) the Lorillard Group's manufacturing facilities and offices in Greensboro, North Carolina, leaf storage facility in Danville, Virginia, sales and other workforces and related plant and infrastructure, certain of which will be transferred to ITG Brands pursuant to the Transfer Agreement as further described in paragraph 3 below.

In addition, the Acquisition will also include the transfer to ITG Brands of the *Doral* cigarette brand in the U.S. for no additional consideration if the aggregate market share in the U.S. of the *Winston*, *Kool* and *Salem* brands for the three months ended prior to the month in which the completion of the Acquisition occurs falls below 4.9 per cent.

##### 2.2 Consideration

The total cash consideration payable by ITG Brands to Reynolds in respect of the Acquired Assets will be US\$7.056 billion, and will be payable upon completion of the Acquisition.

##### 2.3 Conditions

Completion of the Acquisition is conditional upon the fulfilment (or, where applicable, waiver) of the conditions set out in the Asset Purchase Agreement, which include, amongst other things:

- (a) approval by Imperial's Shareholders at the General Meeting;
- (b) expiration or early termination of the waiting period under the HSR Act with respect to the Merger and, if applicable, the Acquisition, and, following Reynolds' and Lorillard's shareholder approval, the subsequent completion of the Merger;
- (c) the absence of any law or governmental order that prohibits or materially restrains the sale or transfer of the Acquired Assets or the other transactions contemplated by the Asset Purchase Agreement;
- (d) the United States District Court for the District of Columbia having entered an order subjecting ITG Brands to the final judgment and remedial order in relation to the DOJ Case in respect of the Acquired Tobacco Cigarette Brands;

- (e) no written communication from NAAG, which coordinates the MSA on behalf of the States, having been made to ITG Brands, Reynolds or Lorillard indicating that NAAG will not change on or after completion of the Acquisition the MSA brands listing with respect to the Acquired Tobacco Cigarette Brands;
- (f) no written communication from one or more States or NAAG having been made to ITG Brands, Reynolds or Lorillard that provides that such State(s) intend to de-list or not to (re-)certify any of the Acquired Tobacco Cigarette Brands, where such de-listing or failure to (re-)certify would be reasonably likely to result in the inability of ITG Brands to sell any or all of the Brands in any State(s) which have an MSA Allocable Share of 5 per cent. or greater;
- (g) no written objection by any State or the independent auditor that determines payments under the MSA and certain other State settlements or NAAG (as applicable) having been made to ITG Brands, Reynolds or Lorillard in respect of the agreed treatment of the Acquired Tobacco Cigarette Brands after completion of the Acquisition under the MSA and such other State settlements as set out in the Asset Purchase Agreement; and
- (h) the representations and warranties provided by each of the parties being true and correct subject to certain qualifications in accordance with the Asset Purchase Agreement and the performance and compliance by the parties in all material respects of their respective covenants, agreements and obligations contained in the Asset Purchase Agreement to be performed on or before completion of the Asset Purchase Agreement.

Subject to the terms and conditions set out in the Asset Purchase Agreement, ITG Brands and Reynolds have agreed to cooperate with each other and use their reasonable best efforts to obtain all required authorisations, consents, orders and approvals in connection with the Acquisition.

If necessary to obtain the expiration or early termination of the waiting period under the HSR Act with respect to the Merger, or to eliminate any legal restraint preventing the consummation of the Merger, the Merger Agreement requires Reynolds to divest the *Doral* cigarette brand and, to the extent it does not give rise to a 'Substantial Detriment' as defined under the Merger Agreement, assets that are not brands or product lines, and agree to behavioural commitments or other limitations in its business.

Under the terms of the Asset Purchase Agreement, neither ITG Brands nor its affiliates are required to divest any assets or take any action that would limit their freedom of operation with respect to, or their ability to retain, any businesses.

## 2.4 Representations and warranties

Reynolds has provided certain representations and warranties to ITG Brands in respect of the Reynolds business and the Lorillard business, in each case in relation to the Acquired Assets, including, but not limited to: (a) power and authority to enter into and perform its obligations under the Asset Purchase Agreement and related agreements; (b) financial information on the Acquired Assets; (c) title to assets; (d) compliance with laws; (e) MSA and State settlement arrangements; (f) intellectual property and licensing arrangements; (g) environmental and real estate matters; and (h) employees and employee benefits. These representations and warranties are customary for a U.S. acquisition of the size and nature of the Acquisition. The representations and warranties of Reynolds in respect of the Lorillard business are qualified by: (i) the actual knowledge of certain members of Reynolds management based on due diligence conducted in connection with the Merger; and (ii) knowledge based on representations of Lorillard to Reynolds as to relevant matters.

Imperial and ITG Brands have also provided customary representations and warranties to Reynolds in respect of, amongst other things the power and authority to enter into and perform their obligations under the Asset Purchase Agreement and the financing arrangements for this transaction, including a sufficiency of funds warranty at signing and up to completion of the Acquisition.

The representations and warranties are subject to certain qualifications and limitations customary for a U.S. acquisition of the size and nature of the Acquisition. In particular, claims in respect of the majority of representations and warranties (excluding title and capacity



representations and warranties) must be brought within 18 months of the completion of the Acquisition or within three years of completion in respect of certain intellectual property and environmental matters.

## **2.5 Provision of Imperial guarantee**

The Asset Purchase Agreement includes a guarantee by Imperial of the following obligations of ITG Brands: (i) the payment by ITG Brands of the purchase price when due; (ii) the full payment and performance of ITG Brands' obligations under the Asset Purchase Agreement to the extent such obligations are to be performed by ITG Brands at or prior to the completion of the Acquisition; and (iii) the payment by ITG Brands under any judgment against ITG Brands (or any related settlement) resulting from a breach of ITG Brands' obligations under certain ancillary agreements that have been entered into or will, at completion of the Acquisition, be entered into between ITG Brands and Reynolds.

## **2.6 Indemnification**

### *(a) Product liability litigation claims*

Reynolds has agreed to indemnify ITG Brands and its affiliates in respect of all product liability litigation claims (whether smoking and health-related claims or other claims relating to the manufacture, distribution and sale of products) in respect of the Acquired Tobacco Cigarette Brands relating exclusively to the period prior to the completion of the Acquisition.

ITG Brands has agreed to indemnify Reynolds and its affiliates in respect of all product liability litigation claims (whether smoking and health-related claims or other claims relating to the manufacture, distribution and sale of products) in respect of the Acquired Tobacco Cigarette Brands relating exclusively to the period after the completion of the Acquisition.

In respect of any product liability litigation claims (whether smoking and health-related claims or other claims relating to the manufacture, distribution and sale of products) that relate to both the pre- and post- completion periods, any liabilities (and the corresponding indemnities) will be allocated on a pro-rata basis between Reynolds and ITG Brands, subject to certain additional indemnification arrangements by Reynolds in the eight year period following completion of the Acquisition.

### *(b) Other matters*

Reynolds has agreed to indemnify ITG Brands and its affiliates in respect of, amongst other things: (a) subject to certain limitations and exceptions, the failure of any representation or warranty made by Reynolds in the Asset Purchase Agreement or the ancillary documents to be true and correct; (b) breach of or failure to perform any covenant or obligation of Reynolds in the Asset Purchase Agreement or the ancillary documents (including in respect of the court order relating to the DOJ Case); (c) the excluded assets and liabilities set out in the Asset Purchase Agreement; (d) certain payments including a portion of attorney's fees, if required, under the MSA and other State settlements; (e) certain potential obligations under the court order relating to the DOJ Case; (f) any breach by Reynolds of the agreed treatment of the Acquired Tobacco Cigarette Brands after completion of the Acquisition under the MSA and other relevant State settlement agreements that results in greater payments under the settlements; (g) any liability under any defined benefit plan, other than in relation to the Lorillard defined benefit pension plan for hourly union workers (which ITG Brands will assume); and (h) any liability under the 2008 separation arrangements between Loews Corporation and Lorillard.

ITG Brands has agreed to indemnify Reynolds and its affiliates in respect of, amongst other things: (i) subject to certain limitations and exceptions, the failure of any representation or warranty made by Imperial or ITG Brands in the Asset Purchase Agreement or the ancillary documents to be true and correct; (ii) breach of or failure to perform any covenant or obligation of Imperial or ITG Brands in the Asset Purchase Agreement or the ancillary documents (including, in the case of Imperial, in relation to the guarantee provisions); (iii) the assumed liabilities set out in the Asset Purchase Agreement;

and (iv) any breach by ITG Brands of the agreed treatment of the Acquired Tobacco Cigarette Brands after completion of the Acquisition under the MSA and other relevant State settlement agreements that results in greater payments under the settlements.

The indemnities provided by ITG Brands and Reynolds in respect of the failure of any representation or warranty to be true and correct and the breach of or failure to perform any covenant or obligation prior to completion of the Acquisition are subject to certain monetary limitations, including that the aggregate liability of each of ITG Brands and Reynolds for such indemnification will be US\$425 million.

## **2.7 Pre-completion covenants and restrictive covenants**

During the period between signing and completion of the Asset Purchase Agreement, Reynolds has agreed, subject to certain exceptions, to comply with certain obligations in relation to the conduct of its business, and to ensure that Lorillard complies with certain obligations in relation to the conduct of its business, as is customary for a transaction of this nature. Such obligations include the obligation to use its reasonable best efforts to conduct the business relating to the Brands in the ordinary course, seeking to preserve the material business relationships and goodwill associated with the Brands and (except with the prior consent of ITG Brands) refraining from certain actions in relation to certain assets, contracts and employees.

ITG Brands and Reynolds have agreed, subject to the terms of the Asset Purchase Agreement and the Merger Agreement, to refrain from taking any action that would reasonably be expected to impair, delay or impede the completion of the Acquisition.

Reynolds and ITG Brands have agreed to employee non-solicitation restrictions on both parties for an 18-month period following completion of the Acquisition, subject to customary carve-outs.

## **2.8 Employment and employee benefits matters**

ITG Brands will offer employment to all of the current employees of the Lorillard Group and to the employees of the Reynolds Group in respect of the Puerto Rico business referred to in paragraph 2.1 above, in each case other than those employees whom Reynolds and ITG Brands mutually agree shall be retained by the Reynolds Group following the completion of the Acquisition. Offers of employment will be made on substantially comparable terms and conditions to those employee benefits provided immediately prior to completion of the Acquisition.

## **2.9 Other provisions**

The Asset Purchase Agreement also contains the following provisions:

### **(a) Termination**

Either ITG Brands or Reynolds may terminate the Asset Purchase Agreement if, among other things, the Acquisition has not been completed on or before the first anniversary of the Asset Purchase Agreement provided, however, that unless Reynolds and ITG Brands mutually agree in writing to the contrary prior to such time, this date will be automatically extended by six months if the only conditions to completion of the Acquisition that have not been satisfied or waived are: (i) the regulatory conditions in the Merger Agreement; (ii) the existence at that time of any injunction or government order seeking to restrain the transaction in connection with any antitrust, competition or trade regulation matter; or (iii) one or more of the conditions referred to in paragraphs 2.3(e), (f) or (g) above.

The Asset Purchase Agreement may be terminated prior to completion: (i) by the mutual written consent of Reynolds and ITG Brands; (ii) by Reynolds if Imperial or ITG Brands have breached any representation, warranty, covenant or agreement that would cause any of the conditions to be incapable of satisfaction by the long stop date referred to above (provided Reynolds is not then in material breach of the Asset Purchase Agreement); or (iii) by ITG Brands if Reynolds has breached any representation, warranty, covenant or agreement that would cause any of the conditions to be incapable of satisfaction by the long stop date referred to above (provided neither Imperial nor ITG Brands is then in material breach of the Asset Purchase Agreement).



The Asset Purchase Agreement further provides for the payment of termination fees by either ITG Brands or Reynolds upon a termination of the Asset Purchase Agreement in certain circumstances, including: (a) a termination fee of US\$210 million payable by Reynolds to ITG Brands in certain circumstances upon a termination of the Merger Agreement that results in the receipt by Reynolds of a termination fee under the Merger Agreement and (b) a termination fee of US\$210 million payable by ITG Brands to Reynolds in certain circumstances in the event that the Imperial Board ceases to recommend the Acquisition to Shareholders or fails to include such recommendation in the circular sent to Shareholders in relation to the Acquisition.

(b) *MSA/other State settlements*

The Asset Purchase Agreement sets out the agreement between Reynolds and ITG Brands as to the treatment of the Acquired Tobacco Cigarette Brands after completion of the Acquisition under the MSA and other relevant State settlement agreements.

Subject to the terms and conditions set out in the Asset Purchase Agreement, ITG Brands and Reynolds have agreed to cooperate with each other and use their reasonable best efforts to reflect the agreed treatment of the Acquired Tobacco Cigarette Brands both before and after completion of the Acquisition in their interactions with the States and other relevant third parties in respect of the MSA and such other State settlements, as well as making communications and taking actions to obtain all required re-certifications of the Acquired Tobacco Cigarette Brands for sale in the States.

(c) *DOJ Case*

The Asset Purchase Agreement sets out the agreement between Reynolds and ITG Brands as to the joinder of ITG Brands to the final judgment and remedial order in relation to the DOJ Case in respect of the Acquired Tobacco Cigarette Brands.

Subject to the terms and conditions set out in the Asset Purchase Agreement, ITG Brands and Reynolds have agreed to cooperate with each other and use their reasonable best efforts to obtain the joinder on the terms agreed upon in the Asset Purchase Agreement, and Reynolds has agreed to indemnify ITG Brands for certain potential obligations under the order.

### **3. Transfer Agreement**

On 15 July 2014, ITG Brands and Lorillard entered into the Transfer Agreement, pursuant to which, immediately prior to the completion of the Merger, Lorillard will transfer specified Acquired Assets, including certain real estate assets, to ITG Brands and ITG Brands will assume specified liabilities, including under certain employee benefit plans, from Lorillard. Such transfer of assets and assumption of liabilities under the Transfer Agreement is conditional on the satisfaction (or, where applicable, waiver) of the conditions to the Merger Agreement and the Asset Purchase Agreement. The Transfer Agreement will automatically terminate upon the termination of the Merger Agreement or the Asset Purchase Agreement.

### **4. Certain ancillary agreements**

Certain ancillary agreements, including the Reciprocal Manufacturing Agreement, the Route to Market Agreement and a transitional services agreement, have been or will at completion of the Acquisition be entered into between ITG Brands, Reynolds, Lorillard and/or their respective affiliates.

#### **4.1 Reciprocal Manufacturing Agreement**

Upon completion of the Acquisition, RJR Tobacco and ITG Brands will enter into the Reciprocal Manufacturing Agreement pursuant to which, for a transitional period, RJR Tobacco, at the Tobaccoville facility, will exclusively manufacture and supply ITG Brands' requirements for *Winston*, *Kool* and *Salem* brand products and, in certain circumstances, *Doral* brand products and ITG Brands, at the Greensboro facility, will exclusively manufacture and supply RJR Tobacco's requirements for *Newport* brand products, in each case at cost plus 10 per cent. (excluding leaf costs).

(a) *Indemnification*

Each party has agreed to indemnify the other party and its affiliates in respect of any losses resulting from: (i) any breach of the representations, warranties, and covenants set out in the Reciprocal Manufacturing Agreement; or (ii) the marketing, advertising, distribution or sale by a party, in its capacity as a customer of any products manufactured by the other party, in its capacity as a manufacturer. Where the indemnification provisions of the Asset Purchase Agreement conflict with the Reciprocal Manufacturing Agreement, the Asset Purchase Agreement will prevail.

(b) *Term*

The Reciprocal Manufacturing Agreement is for an initial term of two years, after which the agreement and the relevant manufacturer-customer relationships will automatically renew for successive one year periods, unless terminated or not renewed as provided below.

The Reciprocal Manufacturing Agreement may be terminated as follows: (a) by mutual consent of the parties; or (b) by a party, by giving written notice to the other party at any time upon the occurrence of any of the following events: (i) the voluntary bankruptcy of the other party; (ii) failure by the other party to pay its debts as they mature in the ordinary course of business, or an assignment by the other party for the benefit of its creditors; or (iii) appointment of a receiver for the other party or its property.

A party may terminate or elect to not renew, as applicable, its customer relationship with its manufacturer: (a) at the end of the initial two-year term or then-effective one-year renewal term; (b) if the relevant manufacturer suffers an event beyond its control which causes an inability to perform or delay in performing any term in the Reciprocal Manufacturing Agreement, and such event is not alleviated to the reasonable satisfaction of the customer; (c) in the event the relevant manufacturer suffers one or more of the events that would result in termination of the Reciprocal Manufacturing Agreement, as described in part (b) of the immediately preceding paragraph; (d) in the event that the other party is in breach of any material term of the Reciprocal Manufacturing Agreement and the other party fails to cure the breach within 30 days; (e) if, in the customer's good faith judgment, it believes that it can migrate manufacturing to itself (or another person) in accordance with a migration plan, provided that the termination will not be effective before the completion of such customer's migration plan; or (f) if both: (i) the action of any governmental authority prohibits or declares it unlawful or otherwise impairs any obligation of a party as contemplated by the Reciprocal Manufacturing Agreement; and (ii) the parties are unable to propose a feasible way of avoiding such interference.

#### **4.2 Route to Market Agreement**

On 15 July 2014 ITG Brands and Reynolds entered into the Route to Market Agreement pursuant to which they agreed that they will comply with certain shelf space and wholesale channel obligations in respect of the Acquired Tobacco Cigarette Brands before and after completion of the Acquisition.

During the period between signing and completion of the Asset Purchase Agreement, the Reynolds Group will continue to sell the Acquired Tobacco Cigarette Brands and use the shelf space allocated to the Acquired Tobacco Cigarette Brands in accordance with historical practice. There will be a five-month standstill period after completion of the Acquisition during which the Reynolds Group and ITG Brands will not make significant changes to the retail shelf space occupied by the Acquired Tobacco Cigarette Brands. During the 12-month period beginning on expiry of the standstill period, the Reynolds and ITG Brands' contracts with retailers must comply with certain stipulations set out in the Route to Market Agreement with regard to the amount of shelf space allocated to the relevant party. In addition, the Reynolds Group must not enter into any exclusive contracts with retailers during this period.

**PART 5**  
**FINANCIAL INFORMATION**

**SECTION A**

**ACCOUNTANTS' REPORT ON THE HISTORICAL FINANCIAL INFORMATION  
RELATING TO THE REYNOLDS BUSINESS**



The Directors  
Imperial Tobacco Group PLC  
121 Winterstoke Road  
Bristol  
BS3 2LL

Credit Suisse Securities (Europe) Limited  
One Cabot Square  
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E14 4QJ

15 December 2014

Dear Sirs

**Historical financial information relating to the assets to be acquired as part of the Acquisition which are owned by, or relate to, Reynolds American Inc. as at the date of this document (the Reynolds Business)**

We report on the financial information relating to the Reynolds Business as set out in Section B of Part 5 (Financial Information) (the **Reynolds Business Historical Financial Information**). The Reynolds Business Historical Financial Information has been prepared for inclusion in the circular dated 15 December 2014 (the **Circular**) of Imperial Tobacco Group PLC (the **Company** or **Imperial**) on the basis of the accounting policies set out in note 2 of the Reynolds Business Historical Financial Information. This report is required by item 13.5.21R of the Listing Rules and is given for the purpose of complying with that item and for no other purpose.

**Responsibilities**

The Directors of the Company are responsible for preparing the Reynolds Business Historical Financial Information in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the Reynolds Business Historical Financial Information gives a true and fair view, for the purposes of the Circular and to report our opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and which we may have to shareholders of the Company as a result of the inclusion of this report in the Circular, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with item 13.4.1R(6) of the Listing Rules, consenting to its inclusion in the Circular.

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*PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH*

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.

**Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the Reynolds Business' circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

**Opinion**

In our opinion, the Reynolds Business Historical Financial Information gives, for the purposes of the Circular dated 15 December 2014, a true and fair view of the state of affairs of the Reynolds Business as at the dates stated and of its profits, cash flows and changes in invested deficit for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Yours faithfully

PricewaterhouseCoopers LLP  
Chartered Accountants

## SECTION B

### HISTORICAL FINANCIAL INFORMATION RELATING TO THE REYNOLDS BUSINESS

**Combined Income Statement  
for the year ended 31 December**

\$ million	Note	2013	2012	2011
<b>Revenue</b>		<b>2,800</b>	<b>3,076</b>	<b>3,128</b>
Duty and similar items		(1,347)	(1,504)	(1,573)
(Other cost of sales)		(183)	(184)	(189)
Cost of sales		<b>(1,530)</b>	<b>(1,688)</b>	<b>(1,762)</b>
<b>Gross profit</b>		<b>1,270</b>	<b>1,388</b>	<b>1,366</b>
Distribution, advertising and selling costs		(320)	(434)	(383)
Amortisation of acquired intangibles		(69)	(93)	(93)
Other expenses		(117)	(87)	(107)
<b>Administrative and other expenses</b>	<b>4</b>	<b>(186)</b>	<b>(180)</b>	<b>(200)</b>
<b>Operating profit / profit before taxation</b>		<b>764</b>	<b>774</b>	<b>783</b>
Taxation	6	(293)	(278)	(293)
<b>Profit for the year</b>		<b>471</b>	<b>496</b>	<b>490</b>

Profit for the periods presented is entirely attributable to the owners of the Reynolds Business (as defined in note 1).

There are no other items of comprehensive income or expense. Accordingly, no Combined Statement of Comprehensive Income is presented.

The combined financial information may not be representative of future results, for example, the historical capital structure does not reflect the future capital structure and future interest income and expense, pension costs and certain other operating costs and tax charges may be significantly different from those that resulted from being wholly owned by Reynolds and its subsidiaries from time to time and where the context requires, each one of them (the **Reynolds Group**).

The notes on pages 46 to 57 are an integral part of the combined historical financial information.



**Reconciliation from operating profit to EBITDA**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Operating profit / Profit before taxation	764	774	783
Amortisation	69	93	93
<b>EBITDA</b>	<b>833</b>	<b>867</b>	<b>876</b>

**Reconciliation from Revenue to Net revenue**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Revenue	2,800	3,076	3,128
Duty and similar items	(1,347)	(1,504)	(1,573)
<b>Net Revenue</b>	<b>1,453</b>	<b>1,572</b>	<b>1,555</b>

**Reconciliation from Gross profit to Brand contribution**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Gross profit	1,270	1,388	1,366
Advertising and support	(246)	(356)	(292)
<b>Brand contribution</b>	<b>1,024</b>	<b>1,032</b>	<b>1,074</b>

**Combined Balance Sheet  
at 31 December**

<b>\$ million</b>	<b>Note</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Non-current assets</b>				
Intangible assets	7	—	69	162
Deferred tax assets	11	172	198	171
		<b>172</b>	<b>267</b>	<b>333</b>
<b>Current assets</b>				
Inventories	8	119	109	113
Trade and other receivables	9	55	50	60
		<b>174</b>	<b>159</b>	<b>173</b>
<b>Total assets</b>		<b>346</b>	<b>426</b>	<b>506</b>
<b>Current liabilities</b>				
Trade and other payables	10	(516)	(680)	(702)
		<b>(516)</b>	<b>(680)</b>	<b>(702)</b>
<b>Total liabilities</b>		<b>(516)</b>	<b>(680)</b>	<b>(702)</b>
<b>Net liabilities</b>		<b>(170)</b>	<b>(254)</b>	<b>(196)</b>
<b>Invested deficit attributable to owners of Reynolds Business</b>				
Invested deficit		(170)	(254)	(196)
<b>Total invested deficit</b>		<b>(170)</b>	<b>(254)</b>	<b>(196)</b>

The notes on pages 46 to 57 are an integral part of the combined historical financial information.

**Combined Statement of Changes in Invested Deficit  
for the year ended 31 December**

<b>\$ million</b>	<b>Invested Deficit</b>
<b>At 1 January 2013</b>	<b>(254)</b>
Profit for the year	471
<b>Total comprehensive income</b>	<b>471</b>
<b>Transactions with owners</b>	
Transactions with owners of Reynolds Business	(387)
<b>At 31 December 2013</b>	<b>(170)</b>
<b>At 1 January 2012</b>	<b>(196)</b>
Profit for the year	496
<b>Total comprehensive income</b>	<b>496</b>
<b>Transactions with owners</b>	
Transactions with owners of Reynolds Business	(554)
<b>At 31 December 2012</b>	<b>(254)</b>
<b>At 1 January 2011</b>	<b>(133)</b>
Profit for the year	490
<b>Total comprehensive income</b>	<b>490</b>
<b>Transactions with owners</b>	
Transactions with owners of Reynolds Business	(553)
<b>At 31 December 2011</b>	<b>(196)</b>

The notes on pages 46 to 57 are an integral part of the combined historical financial information.

**Combined Statement of Cash Flows  
for the year ended 31 December**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>			
Operating profit	764	774	783
Amortisation	69	93	93
Tax paid	(267)	(305)	(306)
Operating cash flows before movement in working capital	<b>566</b>	<b>562</b>	<b>570</b>
(Increase)/decrease in inventories	(10)	4	20
(Increase)/decrease in trade and other receivables	(5)	10	(2)
Decrease in trade and other payables	(164)	(22)	(35)
<b>Movement in working capital</b>	<b>(179)</b>	<b>(8)</b>	<b>(17)</b>
<b>Net cash flows generated by operating activities</b>	<b>387</b>	<b>554</b>	<b>553</b>
<b>Cash flows from financing activities</b>			
Transactions with owners of Reynolds Business	(387)	(554)	(553)
<b>Net cash used in financing activities</b>	<b>(387)</b>	<b>(554)</b>	<b>(553)</b>
<b>Net increase in cash and cash equivalents</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at start of year</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at end of year</b>	<b>—</b>	<b>—</b>	<b>—</b>

The Reynolds Group uses a centralised approach to cash management and financing its operations. Transactions between Reynolds and the carve-out group are accounted for through invested deficit. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the carve-out in this historical financial information.

The notes on pages 46 to 57 are an integral part of the combined historical financial information.

## NOTES TO THE COMBINED HISTORICAL FINANCIAL INFORMATION

### 1 Background to the transaction and nature of the business

#### Background to the transaction

On 15 July 2014, Reynolds, Lorillard, Inc. (**Lorillard**) and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds American Inc. (**Reynolds**), entered into an agreement and plan of merger (the **Merger Agreement**). Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will, directly or indirectly, own 100 per cent. of the outstanding capital stock of Lorillard (the **Merger**).

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, LLC (formerly called Lignum-2 L.L.C.) (a wholly-owned subsidiary of Imperial) (**ITG Brands**), and Reynolds entered into an agreement (the **Asset Purchase Agreement**), pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands (and/or any one or more of Imperial's subsidiaries from time to time (the **Imperial Group**)) the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*, and the associated assets, employees, offices, production facilities and certain associated liabilities of Reynolds and Lorillard and their relevant affiliates (the **Acquired Assets**) (the **Acquisition**). Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent (*Winston*, *Kool* and *Salem*, together with *Maverick* and, if applicable, the *Doral* brand being the **Acquired Tobacco Cigarette Brands**).

#### Nature of the business

The *Winston*, *Salem* and *Kool* brands (**WSK**) and the Puerto Rico operations (the **Puerto Rico Operations**), and the associated assets, properties, licences, rights, employees and certain associated liabilities which form part of the Acquired Assets and are being acquired by ITG Brands or a member of the Imperial Group as part of the Acquisition and that are owned by, or relate to, the Reynolds Group as at the date of this document are hereafter referred to as the **Reynolds Business**. The Reynolds Business does not include the results of the *Doral* brand.

The accompanying historical financial information reflects the assets, liabilities, revenues and expenses directly attributed to the Reynolds Business (**Reynolds Business Historical Financial Information** or **Reynolds HFI**).

The Lorillard HFI on the Acquired Assets owned as the date of this document by Lorillard is set out in Section E of Part 5.

### 2 Accounting Policies

#### Basis of Preparation

The Reynolds Business has not comprised a separate legal entity or group of entities for the years ended 31 December 2013, 2012 and 2011. The Reynolds HFI, which has been prepared specifically for the purpose of this document, is therefore prepared on a basis that combines the results, assets and liabilities of the Reynolds Business by applying the principles underlying the consolidation procedures of IFRS 10 'Consolidated Financial Statements' (**IFRS 10**) for each of the three years ended 31 December 2013, 2012 and 2011 and as at these dates. On such basis, the Reynolds HFI sets out the combined balance sheet as at 31 December 2013, 2012 and 2011 and the results of operations and cash flows for the three years then ended.

The Reynolds HFI has been prepared in accordance with the requirements of the Listing Rules, and in accordance with this basis of preparation. This basis of preparation describes how the Reynolds HFI has been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and the IFRS Interpretation Committee interpretations (together **IFRS**). References to "IFRS" hereafter should be construed as references to IFRS as adopted by the EU. The principal accounting policies that have been applied to the Reynolds HFI are set out below. These policies have been consistently applied to



all years presented unless otherwise stated. The Reynolds HFI has been prepared in accordance with IFRS consistent with that applied by Imperial in its 30 September 2014 financial statements.

IFRS does not provide for the preparation of combined financial information and accordingly in preparing the Reynolds HFI certain accounting conventions commonly used for the preparation of historical financial information for inclusion in investment circulars as described in the Annexure to SIR 2000 “Standards for Investment Reporting applicable to public reporting engagements on historical financial information” issued by the U.K. Auditing Practices Board have been applied.

The Reynolds HFI is presented in millions of U.S. dollars (\$) and is prepared on an historical cost and going concern basis. The planned separation of the Reynolds Business has been considered and it is expected that the appropriate funding will be available for future operations after the separation occurs. It is expected that following separation from Reynolds, the Reynolds Business will continue operating. The Business’ forecasts and projections, taking account of possible changes in trading performance show that the Reynolds Business will be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

The following summarises the accounting and other principles applied in preparing the Reynolds HFI:

The Reynolds HFI was prepared using the Reynolds Business’ historical records of its assets and liabilities, and includes all sales, costs, assets and liabilities directly attributable to the Reynolds Business. Costs directly associated with the Reynolds Business, for example, the costs associated with manufacturing, are separately identifiable and have been included directly within the Reynolds HFI.

In addition, there are a number of other indirect central costs which have been allocated into the Reynolds HFI to reflect the fact that the Reynolds Business operated as part of the wider Reynolds Group. These costs primarily relate to the sales force, general marketing and merchandising, and general corporate expenses related to finance, legal, information technology, human resources, communications, and internal audit. These expenses have been allocated to the Business on the basis of direct usage when identifiable, with the remainder allocated on the basis of volumes.

All such costs and expenses have been deemed to have been settled by the Reynolds Business to Reynolds in the period in which the costs were incurred. Invested deficit in the Reynolds Business as shown in the Combined Balance Sheet includes amounts due to / from Reynolds as well as intercompany receivables / payables with Reynolds.

Reynolds uses a centralised approach to cash management and financing its operations. Transactions between Reynolds and the Reynolds Business are accounted for through invested deficit. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the Reynolds Business in the Reynolds HFI.

The income taxes charged to the Combined Income Statement have been prepared on a separate return basis as if the carve-out group was a stand-alone entity. Historically, it was included in tax filings with other group entities. It does not maintain taxes payable to/from Reynolds, and it is deemed to settle the annual current tax balances immediately with the legal taxpaying entities. These settlements are reflected as changes in invested deficit.

The Acquisition does not include historical liabilities relating to tobacco litigation and associated external fees. Accordingly, the tobacco litigation costs and provisions and related external legal fees in defending the actions have been carved out from the Reynolds HFI on the basis that such claims are against R.J. Reynolds Tobacco Company, a wholly owned subsidiary of Reynolds which does not form part of the Acquisition (**RJR Tobacco**), and are not brand specific. Similarly, whilst the Reynolds HFI includes estimated amounts payable under the MSA (as such term is defined in these notes), it excludes the impact of recent settlements of disputes under the MSA involving payment adjustments relating to non-participating manufacturers as these were agreed by RJR Tobacco and are not brand specific.

**Foreign Currency**

Items included in the Reynolds HFI are measured using the currency of the primary economic environment in which the Business operates (the functional currency). The Reynolds HFI is presented in U.S. dollars (\$), which is also the Reynolds Business' functional currency. There are no transactions in currencies other than U.S. dollar.

**Revenue Recognition**

Revenue comprises the invoiced value for the sale of goods net of sales taxes, rebates and discounts. Revenue from the sale of goods is recognised when the Reynolds Business has delivered products to the customer, the customer has accepted the products and collectability of the related receivables is reasonably assured.

**Duty and Similar Items**

Duty and similar items includes duty and levies having the characteristics of duty. In countries where duty is a production tax, duty is included in revenue and in cost of sales in the Combined Income Statement. Where duty is a sales tax, duty is excluded from revenue. Payments due in the U.S. under the MSA are considered to be levies having the characteristics of duty and are treated as a production tax.

**Taxes**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Management periodically evaluates positions taken in tax returns where the applicable tax regulation is subject to interpretation and establishes provisions on the basis of amounts expected to be paid to the tax authorities only where it is considered more likely than not that an amount will be paid or received. This test is applied to each individual uncertain position which is then measured on the single most likely outcome.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the combined historical financial information and the tax base, except if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates that have been enacted or substantively enacted at the balance sheet date, and are expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

**Intangible Assets**

Intangible assets (which relate entirely to trademarks and acquired rights) are initially recognised in the Combined Balance Sheet at historical cost unless they are acquired as part of a business combination, in which case they are initially recognised at fair value. They are shown in the balance sheet at historical cost or fair value (depending on how they were acquired) less accumulated amortisation and impairment. Trademarks and acquired rights are both amortised over a five year estimated useful life when they change from growth to support brands.

**Financial instruments**

Non-derivative financial assets are classified as loans and receivables. Receivables are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. A provision for impairment of receivables is established when there is objective evidence that the Reynolds Business will not be able to collect all amounts due according to the original terms of those receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, and is recognised in the Combined Income Statement.

Non-derivative financial liabilities are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method.

## **Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (**FIFO**) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Leaf tobacco inventory which has an operating cycle that exceeds 12 months is classified as a current asset, consistent with recognised industry practice.

## **Employee benefits**

The Reynolds Business is a member of the Reynolds Group Pension Plan. Because of the nature of the information available to the Reynolds Business it is not possible for the Reynolds Business to obtain sufficient information to enable it to account for the plan as a defined benefit plan. Accordingly it accounts for the plan as a defined contribution plan.

## **New Accounting Standards and Interpretations**

New standards or interpretations which came into effect for the current reporting period did not have a material impact on the net assets or results of the Reynolds Business.

Other standards and interpretations issued, but not yet effective, are not expected to have a material effect on the Reynolds Business' net assets or results.

## **3 Critical Accounting Estimates and Judgments**

The Reynolds Business makes estimates and assumptions regarding the future. Estimates and judgments are continually evaluated based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In the future, actual experience may deviate from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the current financial year are discussed below.

## **Allocations**

The Reynolds HFI includes cost allocations for certain functions provided by Reynolds, which require the use of estimates. These costs have been allocated on a relative volume basis. These costs were affected by the arrangements that existed in the Reynolds Group and are not necessarily representative of the position that will prevail in the future.

## **Legal Proceedings and Disputes**

Reynolds has historically recognised provisions for tobacco-related legal claims in its consolidated financial statements for litigation against its group companies, specifically RJR Tobacco. These legal claims are not directly attributable to specific brands and relate to periods prior to those presented in the Reynolds HFI. Additionally, the *Winston*, *Salem* and *Kool* brands are to be acquired without historic product liabilities. An indemnity against such liabilities has also been provided by Reynolds in the Asset Purchase Agreement to take effect from completion of the Acquisition. Therefore, as there is no rational basis for allocating legal costs to the Reynolds Business, provisions for tobacco-related legal claims and the associated external legal costs have not been allocated or attributed to the Reynolds Business and are excluded from the Reynolds HFI.

## **Master Settlement Agreement costs**

In 1998, Lorillard Tobacco, Philip Morris Incorporated, RJR Tobacco and Brown & Williamson Tobacco Corporation (now an affiliate of RJR Tobacco) (the **Original Participating Manufacturers** or **OPMs**) entered into the Master Settlement Agreement (the **MSA**) with 46 states and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims of those States which were a party to the MSA (the **Settling States**). These same parties had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the **Initial State Settlements** and, together with the MSA, are referred to as the **State Settlement Agreements**).

The State Settlement Agreements provide that the agreements are not admissions, concessions or evidence of any liability or wrongdoing on the part of any party, and were entered into by the OPMs to avoid the further expense, inconvenience, burden and uncertainty of litigation. The portion of ongoing adjusted settlement payments and legal fees to be paid by each OPM is based on its relative share (among the OPMs) of domestic cigarette shipments in the year preceding that in which the payment is due for the MSA and the year in which the payment is due for the other State settlements.

The State Settlement Agreements require that the OPMs make annual payments of US\$10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs' attorneys' fees, subject to an annual cap of US\$500 million, and were required to pay an additional amount of up to US\$125 million in each year through 2008. These payment obligations are the several and not joint obligations of each OPM. The State Settlement Agreements also include provisions relating to significant advertising and marketing restrictions, public disclosure of certain industry documents (now lapsed), limitations on challenges to tobacco control and underage use laws, and other provisions.

From time to time, lawsuits have been brought against participating manufacturers to the MSA, or against one or more of the Settling States, challenging the validity of the MSA on certain grounds, including as a violation of the antitrust laws.

In addition, in connection with the MSA, the OPMs entered into an agreement to establish a \$5.2 billion trust fund payable between 1999 and 2010 to compensate the tobacco growing communities in 14 states (the **Trust**). Payments to the Trust ended in 2005 as a result of an assessment imposed under a federal law, enacted in 2004, repealing the federal supply management program for tobacco growers. Under the law, tobacco quota holders and growers will be compensated over ten years with payments totalling US\$10.1 billion, funded by an assessment on tobacco manufacturers and importers. Payments under the law to qualifying tobacco quota holders and growers commenced in 2005 and completed in 2014.

RJR Tobacco and certain of the other participating manufacturers under the MSA are currently involved in an arbitration with certain of the settling States with respect to the availability for certain market years of a downward adjustment to the annual MSA settlement payment obligation, known as the "NPM Adjustment". RJR Tobacco disputed a total of \$4.7 billion for the years 2003 through 2012.

In November 2012, RJR Tobacco, the other OPMs and certain SPMs and certain settling States entered into a term sheet that set forth the terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. Twenty-four States, comprising about 50% of the MSA share, have now joined the term sheet. The term sheet also set forth a restructured NPM Adjustment process with respect to the States that signed the settlement to be applied on a going-forward basis, starting with the 2013 volume year for certain changes and the 2015 volume year for others. Based on the jurisdictions that signed the term sheet and are bound by its terms, RJR Tobacco will receive credits, collectively, currently estimated to total approximately US\$1.1 billion, with respect to their NPM Adjustment claims for the period from 2003 to 2012.

The Reynolds Business believes that the State Settlement Agreements will materially adversely affect its cash flows and operating income in future years. The degree of the adverse impact will depend, among other things, on the rates of decline in domestic cigarette sales in the premium price and discount price segments, the Reynolds Business' share of the domestic premium price and discount price cigarette segments, and the effect of any resulting cost advantage of manufacturers not subject to significant payment obligations under the State Settlement Agreements.

Whilst the Reynolds HFI includes estimated amounts payable under the MSA, it excludes the impact of recent settlements of disputes under the MSA involving payment adjustments relating to non-participating manufacturers as these were agreed by RJR Tobacco and are not brand specific.

### Promotional Programmes

Retail sales incentives include retail price discounts, coupons and retail display allowances and are recorded as an expense based on amounts estimated as due to customers and consumers at the end of a period based primarily on use and redemption rates.

### Intangible Assets

Intangible assets (which relate to trademarks and acquired rights) are initially recognised in the Combined Balance Sheet at fair value as they were acquired as part of a business combination. They are shown in the balance sheet at fair value (depending on how they are acquired) less accumulated amortisation and impairment.

The Reynolds Business assesses the impairment of intangible assets subject to amortisation whenever events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment review is undertaken if events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review of intangible assets include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of the use of the acquired assets or the strategy for the overall business; and
- significant negative industry or economic trends.

The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the Reynolds Business' accounting estimates in relation to intangible assets affect the amounts reported in the Reynolds HFI, especially the estimates of the expected useful economic lives and the carrying values of those assets. If business conditions were different, or if different assumptions were used in the application of this and other accounting estimates, it is likely that materially different amounts could be reported in the Reynolds Business' combined historical financial information. Current and future levels of volatility and uncertainty over economic conditions are important factors in assessing the reasonableness of these estimates, assumptions and judgments.

See note 7 for further details.

### Income Taxes

The Reynolds Business is subject to income tax in numerous jurisdictions and significant judgment is required in determining the provision for tax. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Reynolds Business recognises provisions for tax based on estimates of the taxes that are likely to become due. Where the final tax outcome is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred tax provisions in the period in which such determination is made.

## 4 Profit Before Taxation

Profit before taxation is stated after charging:

\$ million	2013	2012	2011
Raw materials and consumables used	121	109	133
Allocation of general administrative expenses from Reynolds (note 13)	143	141	156
Amortisation	69	93	93



## 5 Employee costs

Other than the staff in Puerto Rico (2013: 57, 2012: 53, 2011: 50), there are no employees transferring as part of the acquisition of the Reynolds Business. The employee costs represented below include those for the Puerto Rico operations and the allocated expense for the sales force and manufacturing labour that form part of the Reynolds Business.

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Wages and salaries	86	97	109
Social security costs	5	6	7
Pension and postretirement costs	21	(18)	16

In 2012, a negative past service cost arose due to plan amendments resulting from plan design changes primarily impacting the Medicare eligible retirees within RJR Tobacco. These plan changes had the effect of an overall negative pension and postretirement cost. Accordingly, the Reynolds Business has been allocated its proportion of the credit.

Additionally, the Reynolds Business does not have any directors or employees considered to be key management.

## 6. Taxation

### Analysis of charge in the year

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Current tax			
Federal	229	266	269
State and other	38	39	37
<b>Total current tax</b>	<b>267</b>	<b>305</b>	<b>306</b>
Deferred tax			
Federal	27	(25)	(16)
State and other	(1)	(2)	3
<b>Total deferred tax</b>	<b>26</b>	<b>(27)</b>	<b>(13)</b>
<b>Total tax charged to the Combined Income Statement</b>	<b>293</b>	<b>278</b>	<b>293</b>

The income taxes charged to the Combined Income Statement have been prepared on a separate return basis as if the Reynolds Business was a stand-alone entity. Historically, the Reynolds Business was included in tax filings with other group entities. The Reynolds Business does not maintain taxes payable to/from Reynolds, and the Reynolds Business is deemed to settle the annual current tax balances immediately with the legal taxpaying entities. These settlements are reflected as changes in invested deficit.

### Factors affecting the tax charge for the year

The tax on the Business' profit before tax differs from the theoretical amount that would arise using the average U.S. federal income tax rate for the year of 35 per cent. (2012: 35 per cent., 2011: 35 per cent.) as follows:

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Profit before tax</b>	<b>764</b>	<b>774</b>	<b>783</b>
Tax at the federal tax rate of 35% (2012 and 2011: 35%)	267	271	274
Tax effects of:			
State Taxes (Net of Federal Benefit)	37	36	40
Permanent Differences	(10)	(22)	(21)
Prior Year Adjustments	(2)	(4)	2
Other	1	(3)	(2)
<b>Total tax charged to the Combined income statement</b>	<b>293</b>	<b>278</b>	<b>293</b>

## 7 Intangible Assets

2013			
\$ million	Trademarks	Acquired rights	Total
<b>Cost at 1 January 2013</b>	<b>2,729</b>	<b>12</b>	<b>2,741</b>
Amortisation			
At 31 December 2013	2,660	12	2,672
Amortisation charge for the year	69	—	69
<b>At 31 December 2013</b>	<b>2,729</b>	<b>12</b>	<b>2,741</b>
Net book value			
<b>At 31 December 2013</b>	<b>—</b>	<b>—</b>	<b>—</b>
2012			
\$ million	Trademarks	Acquired rights	Total
<b>Cost at 1 January 2012</b>	<b>2,729</b>	<b>12</b>	<b>2,741</b>
Amortisation			
At 1 January 2012	2,567	12	2,579
Amortisation charge for the year	93	—	93
<b>At 31 December 2012</b>	<b>2,660</b>	<b>12</b>	<b>2,672</b>
Net book value			
<b>At 31 December 2012</b>	<b>69</b>	<b>—</b>	<b>69</b>
2011			
\$ million	Trademarks	Acquired rights	Total
<b>Cost at 1 January 2011</b>	<b>2,729</b>	<b>12</b>	<b>2,741</b>
Amortisation			
At 1 January 2011	2,474	12	2,486
Amortisation charge for the year	93	—	93
<b>At 31 December 2011</b>	<b>2,567</b>	<b>12</b>	<b>2,579</b>
Net book value			
<b>At 31 December 2011</b>	<b>162</b>	<b>—</b>	<b>162</b>

Trademarks comprise brands acquired through the purchases of WSK. Acquired rights relate to the distribution rights for *Winston* and *Salem* in U.S. duty-free and overseas U.S. military bases. Intangible amortisation is included within administrative and other expenses in the Combined Income Statement.

## 8 Inventories

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Raw materials	96	85	82
Work in progress	6	6	7
Finished inventories	17	18	24
	<b>119</b>	<b>109</b>	<b>113</b>

It is generally recognised industry practice to classify leaf tobacco inventory as a current asset although part of such inventory, because of the duration of the processing cycle, ordinarily would not be consumed within one year. We estimate that around \$18 million (2012: \$15 million, 2011: \$15 million) of leaf tobacco held within raw materials will not be utilised within a year of the balance sheet date.

## 9 Trade and Other Receivables

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Amounts due within one year:			
Trade receivables	18	16	19
Prepayments and accrued income	37	34	41
	<b>55</b>	<b>50</b>	<b>60</b>

Trade receivables may be analysed as follows:

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Within credit terms	16	15	17
Past due by less than 3 months	2	1	2
	<b>18</b>	<b>16</b>	<b>19</b>

There were no provisions for impairment of trade receivables in any periods. Trade receivables that were written off during the years are less than US\$1 million. The carrying amount of trade and other receivables is a reasonable approximation to their fair value.

## 10 Trade and Other Payables

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Amounts due within one year:			
Trade payables	13	25	21
Tobacco settlement accruals	432	581	600
Other taxes, duties and social security contributions	39	36	45
Other payables	11	16	13
Accruals and deferred income	21	22	23
	<b>516</b>	<b>680</b>	<b>702</b>

The carrying amount of trade and other payables is a reasonable approximation to their fair value.

## 11 Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the Combined Balance Sheet.

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Deferred tax assets	172	224	233
Deferred tax liabilities	—	(26)	(62)
<b>Deferred tax asset (net)</b>	<b>172</b>	<b>198</b>	<b>171</b>

### Deferred tax expected to be recovered within 12 months

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Deferred tax assets	172	224	233
Deferred tax liabilities	—	(26)	(36)
<b>Deferred tax asset (net)</b>	<b>172</b>	<b>198</b>	<b>197</b>

### Deferred tax assets

<b>\$ million</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2013	224	224
Credited/(charged) to Combined income statement	(52)	(52)
At 31 December 2013	<b>172</b>	<b>172</b>

<b>\$ million</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2012	233	233
Credited/(charged) to Combined income statement	(9)	(9)
At 31 December 2012	<b>224</b>	<b>224</b>

<b>\$ million</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2011	254	254
Credited/(charged) to Combined income statement	(21)	(21)
At 31 December 2011	<b>233</b>	<b>233</b>

Temporary differences arise on the timing of the tax deduction for the MSA accrual.

## Deferred tax liabilities

<b>\$ million</b>	<b>Intangible assets</b>	<b>Total</b>
At 1 January 2013	(26)	(26)
Credited/(charged) to Combined income statement	26	26
At 31 December 2013	—	—

  

<b>\$ million</b>	<b>Intangible assets</b>	<b>Total</b>
At 1 January 2012	(62)	(62)
Credited/(charged) to Combined income statement	36	36
At 31 December 2012	(26)	(26)

  

<b>\$ million</b>	<b>Intangible assets</b>	<b>Total</b>
At 1 January 2011	(96)	(96)
Credited/(charged) to Combined income statement	34	34
At 31 December 2011	(62)	(62)

## 12 Commitments

Operating lease commitments in relation to WSK brands are included within the allocation of general administrative expenses. Puerto Rico Operations do not have any material operating leases or lease commitments.

## 13 Related parties

The ultimate controlling party of the Reynolds Business is Reynolds.

The Reynolds HFI includes expense allocations for certain functions provided by Reynolds, including, but not limited to, the sales force, general marketing and merchandising, and general corporate expenses related to finance, legal, information technology, human resources, communications, and internal audit. These expenses have been allocated to the Reynolds Business on the basis of direct usage when identifiable, with the remainder allocated on the basis of volumes. During the years ended 31 December 2013, 31 December 2012 and 31 December 2011, the Reynolds Business was allocated the following general corporate and other expenses incurred by Reynolds, which are included in the Combined Income Statement as follows:

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Other expenses	143	141	156

The other expense allocations have been determined on a basis that both Reynolds and the Reynolds Business consider to be a reasonable reflection of the utilisation of services provided or the benefit received by the Reynolds Business during the periods presented. The allocations may not, however, reflect the expense the Reynolds Business would have incurred as an independent business for the periods presented. Actual costs that may have been incurred if the Reynolds Business had been operating on a stand-alone basis would depend on a number of factors, including the chosen organisation structure, what functions were outsourced or performed by employees and strategic decisions made in areas such as information technology and infrastructure.



### **Parent Investment in the Reynolds Business**

It is not meaningful to show share capital or retained earnings for the Reynolds Business. The net assets are represented by the net investment of Reynolds, which comprises share capital and retained earnings of the Reynolds Business after eliminating investments and transactions between the Reynolds Business, Reynolds or its subsidiaries.

All significant intercompany transactions between Reynolds and the Reynolds Business have been included in this Reynolds HFI and are considered to be effectively settled for cash at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the combined statements of changes in equity.

## **14 Financial Risk Management**

In the normal course of commercial activity the Business is exposed to certain financial risks, as outlined below:

The Reynolds Business has minimal exposure to liquidity risk arising from insufficient funds to meet its financing needs because it has no cash or debt as Reynolds uses a centralised approach to cash management and financing its operations.

The Reynolds Business has minimal exposure to most market risks as it has no debt and its sales transactions are all denominated in U.S. dollars and therefore is not exposed to movements in foreign exchange rates.

There is exposure to commodity price risk in that there may be fluctuations in the price of tobacco leaf. Management actively monitors excess inventories of sellers to purchase when favourable price variances are observed or to delay purchases until prices stabilise. Several months of tobacco leaf supply is held at any point in time, allowing the Reynolds Business to be able to manage its price risk.

The Reynolds Business is exposed to credit risk arising from its trade receivables due from customers, but has implemented policies to ensure that sales of products are made to customers with an appropriate credit history. Management also mitigates its exposure to credit risk by requiring most of its customers to pay in advance of distribution.

The Reynolds Business manages its capital through a centralised approach with Reynolds.

## **15 Subsequent events**

On 15 July 2014, Reynolds, Lorillard and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds, entered into the Merger Agreement. Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will own 100 per cent. of the outstanding capital stock of Lorillard.

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, and Reynolds entered into the Asset Purchase Agreement, pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands certain assets of Reynolds and its relevant affiliates used primarily in, or arising directly or indirectly out of the operation or conduct of, the businesses of the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*. Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent.

## SECTION C

### UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL INFORMATION RELATING TO THE REYNOLDS BUSINESS TO 30 SEPTEMBER 2014

#### Unaudited Condensed Combined Income Statement

\$ million unless otherwise indicated	Note	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
<b>Revenue</b>		<b>1,974</b>	<b>2,120</b>	<b>2,800</b>
Duty and similar items		(942)	(1,020)	(1,347)
Other cost of sales		(125)	(140)	(183)
<b>Cost of sales</b>		<b>(1,067)</b>	<b>(1,160)</b>	<b>(1,530)</b>
<b>Gross profit</b>		<b>907</b>	<b>960</b>	<b>1,270</b>
Distribution, advertising and selling costs		(219)	(243)	(320)
Amortisation of intangible assets		—	(69)	(69)
Other expenses		(74)	(85)	(117)
<b>Administrative and other expenses</b>		<b>(74)</b>	<b>(154)</b>	<b>(186)</b>
<b>Operating profit / profit before taxation</b>		<b>614</b>	<b>563</b>	<b>764</b>
Taxation	4	(227)	(216)	(293)
<b>Profit for the period</b>		<b>387</b>	<b>347</b>	<b>471</b>

Profit for the periods presented is entirely attributable to the owners of the Reynolds Business (as defined in note 1).

There are no other items of comprehensive income or expense. Accordingly, no Combined Statement of Comprehensive Income is presented.

The condensed combined interim financial information may not be representative of future results, for example, the historical capital structure does not reflect the future capital structure and future interest income and expense, pension costs and certain other operating costs and tax charges may be significantly different from those that resulted from being wholly owned by Reynolds and its subsidiaries from time to time and where the context requires, each one of them (the **Reynolds Group**).

The notes on pages 62 to 65 are an integral part of the condensed combined historical financial information.

# Reconciliation from operating profit to EBITDA

<b>\$ million</b>	<b>9 months ended 30 September 2014</b>	<b>9 months ended 30 September 2013</b>	<b>Year ended 31 December 2013</b>
Operating profit / Profit before taxation	614	563	764
Amortisation	—	69	69
<b>EBITDA</b>	<b>614</b>	<b>632</b>	<b>833</b>

# Reconciliation from Revenue to Net revenue

<b>\$ million</b>	<b>9 months ended 30 September 2014</b>	<b>9 months ended 30 September 2013</b>	<b>Year ended 31 December 2013</b>
Revenue	1,974	2,120	2,800
Duty and similar items	(942)	(1,020)	(1,347)
<b>Net Revenue</b>	<b>1,032</b>	<b>1,100</b>	<b>1,453</b>

# Reconciliation from Gross profit to Brand contribution

<b>\$ million</b>	<b>9 months ended 30 September 2014</b>	<b>9 months ended 30 September 2013</b>	<b>Year ended 31 December 2013</b>
Gross profit	907	960	1,270
Advertising and support	(169)	(188)	(246)
<b>Brand contribution</b>	<b>738</b>	<b>772</b>	<b>1,024</b>

## Unaudited Combined Balance Sheet

<b>\$ million</b>	<b>30 September 2014</b>	<b>30 September 2013</b>	<b>31 December 2013</b>
<b>Non-current assets</b>			
Deferred tax assets	142	159	172
	<b>142</b>	<b>159</b>	<b>172</b>
<b>Current assets</b>			
Inventories	118	127	119
Trade and other receivables	42	52	55
	<b>160</b>	<b>179</b>	<b>174</b>
<b>Total assets</b>	<b>302</b>	<b>338</b>	<b>346</b>
<b>Current liabilities</b>			
Trade and other payables	(411)	(461)	(516)
<b>Total liabilities</b>	<b>(411)</b>	<b>(461)</b>	<b>(516)</b>
<b>Net liabilities</b>	<b>(109)</b>	<b>(123)</b>	<b>(170)</b>
<b>Invested deficit attributable to owners of Reynolds Business</b>			
Invested deficit	(109)	(123)	(170)
<b>Total invested deficit</b>	<b>(109)</b>	<b>(123)</b>	<b>(170)</b>

The notes on pages 62 to 65 are an integral part of the condensed combined interim financial information.

## Unaudited Combined Statement of Changes in Invested Deficit

<b>\$ million</b>	<b>Invested deficit</b>
<b>At 1 January 2014</b>	<b>(170)</b>
Profit for the period	387
Total comprehensive income	387
Transactions with owners	
Transactions with owners of Reynolds Business	(326)
<b>At 30 September 2014</b>	<b>(109)</b>
<b>At 1 January 2013</b>	<b>(254)</b>
Profit for the period	347
Total comprehensive income	347
Transactions with owners	
Transactions with owners of Reynolds Business	(216)
<b>At 30 September 2013</b>	<b>(123)</b>

The notes on pages 62 to 65 are an integral part of the condensed combined interim financial information.

## Unaudited Combined Cash Flow Statement

\$ million	9 months ended 30 September 2014	9 months Ended 30 September 2013	Year ended 31 December 2013
<b>Cash flows from operating activities</b>			
Operating profit	614	563	764
Amortisation	—	69	69
<b>Operating cash flows before movement in working capital</b>	<b>614</b>	<b>632</b>	<b>833</b>
Decrease/(increase) in inventories	1	(18)	(10)
Decrease/(increase) in trade and other receivables	13	(2)	(5)
Decrease in trade and other payables	(105)	(219)	(164)
Movement in working capital	(91)	(239)	(179)
Tax paid	(197)	(177)	(267)
<b>Net cash flows generated by operating activities</b>	<b>326</b>	<b>216</b>	<b>387</b>
<b>Cash flows from financing activities</b>			
Transactions with owners of Reynolds Business	(326)	(216)	(387)
<b>Net cash used in financing activities</b>	<b>(326)</b>	<b>(216)</b>	<b>(387)</b>
<b>Net increase in cash and cash equivalents</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at start of period</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at end of period</b>	<b>—</b>	<b>—</b>	<b>—</b>

The Reynolds Group uses a centralised approach to cash management and financing its operations. Transactions between Reynolds and the carve-out group are accounted for through invested deficit. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the carve-out in this interim financial information.

The notes on pages 62 to 65 are an integral part of the condensed combined interim financial information.

## NOTES TO THE CONDENSED COMBINED INTERIM FINANCIAL INFORMATION

### 1 Background to the transaction and nature of the business

#### Background to the transaction

On 15 July 2014, Reynolds, Lorillard, Inc. (**Lorillard**) and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds American Inc. (**Reynolds**), entered into an agreement and plan of merger (the **Merger Agreement**). Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will, directly or indirectly, own 100 per cent. of the outstanding capital stock of Lorillard (the **Merger**).

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, LLC (formerly called Lignum-2 L.L.C.) (a wholly-owned subsidiary of Imperial) (**ITG Brands**), and Reynolds entered into an agreement (the **Asset Purchase Agreement**), pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands (and/or any one or more of Imperial's subsidiaries from time to time (the **Imperial Group**)) the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*, and the associated assets, employees, offices, production facilities and certain associated liabilities of Reynolds and Lorillard and their relevant affiliates (the **Acquired Assets**) (the **Acquisition**). Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent (*Winston*, *Kool* and *Salem*, together with *Maverick* and, if applicable, the *Doral* brand being the **Acquired Tobacco Cigarette Brands**).

#### Nature of the business

The *Winston*, *Salem* and *Kool* brands (**WSK**) and the Puerto Rico operations (the **Puerto Rico Operations**), and the associated assets, properties, licences, rights, employees and certain associated liabilities which form part of the Acquired Assets and are being acquired by ITG Brands or a member of the Imperial Group as part of the Acquisition and that are owned by, or relate to, the Reynolds Group as at the date of this document are hereafter referred to as the **Reynolds Business**. The Reynolds Business does not include the results of the *Doral* brand.

The accompanying interim financial information (the **Reynolds interim financial information**) reflects the assets, liabilities, revenues and expenses directly attributed to the Reynolds Business.

The Lorillard interim financial information on the Acquired Assets owned as at the date of this document by Lorillard is set out in Section F of Part 5.

### 2 Accounting Policies

#### Basis of Preparation

This condensed combined interim financial information comprises the unaudited results for the nine months ended 30 September 2014 and 30 September 2013, together with the audited results for the year ended 31 December 2013.

This condensed set of interim financial information for the nine months ended 30 September 2014 has been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the European Union. The condensed set of interim financial information for the nine months ended 30 September 2014 should be read in conjunction with the Reynolds Business historical financial information (**Reynolds HFI**) for the year ended 31 December 2013 which has been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Reynolds Business' principal accounting policies used in preparing this information are as stated in the Reynolds HFI for the year ended 31 December 2013, as set out in Section B of Part 5 of this document. This interim condensed combined financial information has been prepared in accordance with IFRS consistent with that applied by Imperial in its 30 September 2014 financial statements.



### **New Accounting Standards and Interpretations**

New standards or interpretations which came into effect for the current reporting period did not have a material impact on the net assets or results of the Reynolds Business.

Other standards and interpretations issued, but not yet effective, are not expected to have a material effect on the Reynolds Business' net assets or results.

### **3 Critical Accounting Estimates and Judgments**

The Reynolds Business makes estimates and judgments regarding the future. Estimates and judgments are continually evaluated based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In the future, actual experience may deviate from these estimates and judgments. In preparing this condensed interim financial information, the significant judgments made by management in applying the accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Reynolds HFI for the year ended 31 December 2013.

### **4 Taxation**

Reported tax for the nine months ended 30 September 2014 and 2013 has been calculated on the basis of an estimated effective tax rate for the years ended 31 December 2014 and 2013. The estimated annual tax rate for the year ended 31 December 2014 is 37.0% (the estimated tax rate for the nine months ended 30 September 2013 was 38.4%).

### **5 Legal Proceedings and Disputes**

Reynolds has historically recognized provisions for tobacco-related legal claims in its consolidated financial statements for litigation against its group companies, specifically RJR Tobacco. These legal claims are not directly attributable to specific brands and relate to periods prior to those presented in the interim financial information. Additionally, the *Winston, Salem* and *Kool* brands are to be acquired without historic product liabilities. An indemnity against such liabilities has also been provided by Reynolds in the Asset Purchase Agreement to take effect from completion of the Acquisition. Therefore, as there is no rational basis for allocating legal costs to the Reynolds Business, provisions for tobacco-related legal claims and the associated external legal costs have not been allocated or attributed to the Reynolds Business and are excluded from the Reynolds interim financial information.

#### **Master Settlement Agreement costs**

In 1998, Lorillard Tobacco, Philip Morris Incorporated, RJR Tobacco and Brown & Williamson Tobacco Corporation (now an affiliate of RJR Tobacco) (the **Original Participating Manufacturers** or **OPMs**) entered into the Master Settlement Agreement (the **MSA**) with 46 states and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims of those states which were a party to the MSA (the **Settling States**). These same parties had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the **Initial State Settlements** and, together with the MSA, are referred to as the **State Settlement Agreements**).

The State Settlement Agreements provide that the agreements are not admissions, concessions or evidence of any liability or wrongdoing on the part of any party, and were entered into by the OPMs to avoid the further expense, inconvenience, burden and uncertainty of litigation. The portion of ongoing adjusted settlement payments and legal fees to be paid by each OPM is based on its relative share (among the OPMs) of domestic cigarette shipments in the year preceding that in which the payment is due for the MSA and the year in which the payment is due for the other States Settlements.

The State Settlement Agreements require that the OPMs make annual payments of US\$10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs' attorneys' fees, subject to an annual cap of US\$500 million, and were required to pay an additional amount of up to US\$125 million in each year through 2008. These payment obligations are the several and not joint obligations of each OPM. The State Settlement Agreements also include provisions

relating to significant advertising and marketing restrictions, public disclosure of certain industry documents (now lapsed), limitations on challenges to tobacco control and underage use laws, and other provisions.

From time to time, lawsuits have been brought against participating manufacturers to the MSA, or against one or more of the Settling States, challenging the validity of the MSA on certain grounds, including as a violation of the antitrust laws.

In addition, in connection with the MSA, the OPMs entered into an agreement to establish a US\$5.2 billion trust fund payable between 1999 and 2010 to compensate the tobacco growing communities in 14 states (the **Trust**). Payments to Trust ended in 2005 as a result of an assessment imposed under a federal law, enacted in 2004, repealing the federal supply management program for tobacco growers. Under the law, tobacco quota holders and growers will be compensated over ten years with payments totaling US\$10.1 billion, funded by an assessment on tobacco manufacturers and importers. Payments under the law to qualifying tobacco quota holders and growers commenced in 2005 and completed in 2014.

RJR Tobacco and certain of the other participating manufacturers under the MSA are currently involved in an arbitration with certain of the settling States with respect to the availability for certain market years of a downward adjustment to the annual MSA settlement payment obligation, known as the “NPM Adjustment”. RJR Tobacco disputed a total of \$4.7 billion for the years 2003 through 2012.

In November 2012, RJR Tobacco, the other OPMs and certain SPMs and certain settling States entered into a term sheet that set forth the terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. Twenty-four States, comprising about 50% of the MSA share, have now joined the term sheet. The term sheet also set forth a restructured NPM Adjustment process with respect to the States that signed the settlement to be applied on a going-forward basis, starting with the 2013 volume year for certain changes and the 2015 volume year for others. Based on the jurisdictions that signed the term sheet and are bound by its terms, RJR Tobacco will receive credits, collectively, currently estimated to total approximately US\$1.1 billion, with respect to their NPM Adjustment claims for the period from 2003 to 2012.

The Reynolds Business believes that the State Settlement Agreements will materially adversely affect its cash flows and operating income in future years. The degree of the adverse impact will depend, among other things, on the rates of decline in domestic cigarette sales in the premium price and discount price segments, the Reynolds Business’ share of the domestic premium price and discount price cigarette segments, and the effect of any resulting cost advantage of manufacturers not subject to significant payment obligations under the State Settlement Agreements.

Whilst the condensed combined interim financial information and Reynolds HFI includes estimated amounts payable under the MSA, it excludes the impact of recent settlements of disputes under the MSA involving payment adjustments relating to non-participating manufacturers as these were agreed by RJR Tobacco and are not brand specific.

## 6 Related Parties

The ultimate controlling party of the Reynolds Business is Reynolds.

The Reynolds interim financial information includes expense allocations for certain functions provided by Reynolds, including, but not limited to, the sales force, general marketing and merchandising, and general corporate expenses related to finance, legal, information technology, human resources, communications, and internal audit. These expenses have been allocated to the Reynolds Business on the basis of direct usage when identifiable, with the remainder allocated on the basis of volumes. During the nine months ended 30 September 2014 and 30 September 2013 and the year ended 31 December 2013, the Reynolds Business was allocated the following general corporate and other expenses incurred by Reynolds, which are included in the Combined Income Statement as follows:

	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
<b>\$million</b>			
Other expenses	97	106	143

The other expense allocations have been determined on a basis that both Reynolds and the Reynolds Business consider to be a reasonable reflection of the utilisation of services provided or the benefit received by the Reynolds Business during the periods presented. The allocations may not, however, reflect the expense the Reynolds Business would have incurred as an independent business for the periods presented. Actual costs that may have been incurred if the Reynolds Business had been operating on a stand-alone basis would depend on a number of factors, including the chosen organisation structure, what functions were outsourced or performed by employees and strategic decisions made in areas such as information technology and infrastructure.

### Parent Investment in the Reynolds Business

It is not meaningful to show share capital or retained earnings for the Reynolds Business. The net assets are represented by the net investment of Reynolds, which comprises share capital and retained earnings of the Reynolds Business after eliminating investments and transactions between the Reynolds Business, Reynolds or its subsidiaries.

All significant intercompany transactions between Reynolds and the Reynolds Business have been included in this Reynolds interim financial information and are considered to be effectively settled for cash at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the combined statements of changes in equity.

## SECTION D

### ACCOUNTANTS' REPORT ON THE HISTORICAL FINANCIAL INFORMATION RELATING TO THE LORILLARD BUSINESS



The Directors  
Imperial Tobacco Group PLC  
121 Winterstoke Road  
Bristol  
BS3 2LL  
  
Credit Suisse Securities (Europe) Limited  
One Cabot Square  
London  
E14 4QJ

15 December 2014

Dear Sirs

**Historical financial information relating to the assets to be acquired as part of the Acquisition which are owned by, or relate to, Lorillard Inc. as at the date of this document (the Lorillard Business)**

We report on the financial information relating to the Lorillard Business as set out in Section E of Part 5 (Financial Information) (the **Lorillard Business Historical Financial Information**). The Lorillard Business Historical Financial Information has been prepared for inclusion in the circular dated 15 December 2014 (the **Circular**) of Imperial Tobacco Group PLC (the **Company** or **Imperial**) on the basis of the accounting policies set out in note 2 of the Lorillard Business Historical Financial Information. This report is required by item 13.5.21R of the Listing Rules and is given for the purpose of complying with that item and for no other purpose.

#### **Responsibilities**

The Directors of the Company are responsible for preparing the Lorillard Business Historical Financial Information in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the Lorillard Business Historical Financial Information gives a true and fair view, for the purposes of the Circular and to report our opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and which we may have to shareholders of the Company as a result of the inclusion of this report in the Circular, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with item 13.4.1R(6) of the Listing Rules, consenting to its inclusion in the Circular.

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*PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH*

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.

**Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the Lorillard Business' circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

**Opinion**

In our opinion, the Lorillard Business Historical Financial Information gives, for the purposes of the circular dated 15 December 2014, a true and fair view of the state of affairs of the Lorillard Business as at the dates stated and of its profits, cash flows and changes in invested capital/(deficit) for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Yours faithfully

PricewaterhouseCoopers LLP  
Chartered Accountants

## SECTION E

### HISTORICAL FINANCIAL INFORMATION RELATING TO THE LORILLARD BUSINESS

#### Combined Income Statement for the year ended 31 December

\$ million	Note	2013	2012	2011
<b>Revenue</b>	<b>4</b>	<b>7,900</b>	<b>7,521</b>	<b>7,324</b>
Duty and similar items		(3,581)	(3,550)	(3,502)
Other cost of sales		(656)	(535)	(487)
<b>Cost of sales</b>		<b>(4,237)</b>	<b>(4,085)</b>	<b>(3,989)</b>
<b>Gross profit</b>		<b>3,663</b>	<b>3,436</b>	<b>3,335</b>
Distribution, advertising and selling costs		(1,194)	(1,103)	(1,043)
Acquisition costs		(4)	(6)	—
Amortisation of acquired intangibles		(12)	(4)	(2)
Other expenses		(298)	(285)	(270)
<b>Administrative and other expenses</b>		<b>(314)</b>	<b>(295)</b>	<b>(272)</b>
<b>Operating profit and profit before taxation</b>	<b>5</b>	<b>2,155</b>	<b>2,038</b>	<b>2,020</b>
Taxation	7	(817)	(756)	(756)
<b>Profit for the year</b>		<b>1,338</b>	<b>1,282</b>	<b>1,264</b>

Profit for the periods presented is entirely attributable to the owners of the Lorillard Business (as defined in note 1).

The combined financial information may not be representative of future results, for example, the historical capital structure does not reflect the future capital structure and future interest income and expense, pension costs and certain other operating costs and tax charges may be significantly different from those that resulted from being wholly owned by Lorillard.

The notes on pages 73 to 102 are an integral part of the combined historical financial information.

#### Combined Statement of Comprehensive Income for the year ended 31 December

\$ million	Note	2013	2012	2011
<b>Profit for the year</b>		<b>1,338</b>	<b>1,282</b>	<b>1,264</b>
<b>Other comprehensive income:</b>				
Exchange movements		1	—	—
<b>Items that may be reclassified to profit and loss</b>		<b>1</b>	<b>—</b>	<b>—</b>
Net actuarial gains/(losses) on retirement benefits	15	77	2	(64)
Deferred tax relating to net actuarial gains/(losses) on retirement benefits	13	(32)	(1)	22
<b>Items that will not be reclassified to profit and loss</b>		<b>45</b>	<b>1</b>	<b>(42)</b>
<b>Total comprehensive income for the year</b>		<b>1,384</b>	<b>1,283</b>	<b>1,222</b>

The notes on pages 73 to 102 are an integral part of the combined historical financial information.



### Reconciliation from operating profit to adjusted EBITDA

\$ million	2013	2012	2011
Operating profit / Profit before taxation	2,155	2,038	2,020
Depreciation	43	39	35
Amortisation	13	4	2
<b>EBITDA</b>	<b>2,211</b>	<b>2,081</b>	<b>2,057</b>
Acquisition costs	4	6	—
Volume adjustment offset	57	52	6
<b>Adjusted EBITDA</b>	<b>2,272</b>	<b>2,139</b>	<b>2,063</b>

A non-recurring volume adjustment offset of approximately US\$57 m relating to the Initial State Settlements was incurred by the Lorillard Business in financial year 2013. The volume adjustment offset is dependent on total profitability of the U.S. tobacco industry and is reviewed and calculated on an annual basis should certain thresholds be met.

### Reconciliation from Revenue to Net revenue

\$ million	2013	2012	2011
Revenue	7,900	7,521	7,324
Duty and similar items	(3,581)	(3,550)	(3,502)
<b>Net Revenue</b>	<b>4,319</b>	<b>3,971</b>	<b>3,822</b>

### Reconciliation from Gross profit to Brand contribution

\$ million	2013	2012	2011
Gross profit	3,663	3,436	3,335
Advertising and support	(1,034)	(952)	(899)
<b>Brand contribution</b>	<b>2,629</b>	<b>2,484</b>	<b>2,436</b>

**Combined Balance Sheet  
at 31 December**

<b>\$ million</b>	<b>Note</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Non-current assets</b>				
Intangible assets	8	192	119	1
Property, plant and equipment	9	303	297	261
Deferred tax assets	13	504	497	485
Retirement benefit assets	15	55	—	—
Other		3	9	6
		<b>1,057</b>	<b>922</b>	<b>753</b>
<b>Current assets</b>				
Inventories	10	764	655	501
Trade and other receivables	11	72	58	52
		<b>836</b>	<b>713</b>	<b>553</b>
<b>Total assets</b>		<b>1,893</b>	<b>1,635</b>	<b>1,306</b>
<b>Current liabilities</b>				
Trade and other payables	12	(1,524)	(1,503)	(1,406)
		<b>(1,524)</b>	<b>(1,503)</b>	<b>(1,406)</b>
<b>Non-current liabilities</b>				
Retirement benefit obligations	15	(108)	(111)	(94)
Provisions	14	(27)	—	—
		<b>(135)</b>	<b>(111)</b>	<b>(94)</b>
<b>Total liabilities</b>		<b>(1,659)</b>	<b>(1,614)</b>	<b>(1,500)</b>
<b>Net assets / (liabilities)</b>		<b>234</b>	<b>21</b>	<b>(194)</b>
<b>Invested capital/(deficit) attributable to owners of the Lorillard Business</b>				
Invested capital / (deficit)	19	234	21	(194)
<b>Total invested capital /(deficit)</b>		<b>234</b>	<b>21</b>	<b>(194)</b>

The notes on pages 73 to 102 are an integral part of the combined historical financial information

# Combined Statement of Changes in Invested Capital/(Deficit)

<b>\$ million</b>	<b>Invested Capital/ (Deficit)</b>
<b>At 1 January 2013</b>	<b>21</b>
Profit for the year	1,338
Other comprehensive income	46
<b>Total comprehensive income</b>	
<b>Transactions with owners</b>	1,384
Share based compensation	18
Excess tax benefit on share-based compensation	14
Transactions with owners of the Lorillard Business	(1,203)
<b>At 31 December 2013</b>	<b>234</b>
<b>At 1 January 2012</b>	<b>(194)</b>
Profit for the year	1,282
Other comprehensive income	1
<b>Total comprehensive income</b>	1,283
<b>Transactions with owners</b>	
Share based compensation	20
Excess tax benefit on share-based compensation	11
Transactions with owners of the Lorillard Business	(1,099)
<b>At 31 December 2012</b>	<b>21</b>
<b>At 1 January 2011</b>	<b>(110)</b>
Profit for the year	1,264
Other comprehensive income	(42)
<b>Total comprehensive income</b>	1,222
<b>Transactions with owners</b>	
Share based compensation	11
Excess tax benefit on share-based compensation	4
Transactions with owners of the Lorillard Business	(1,321)
<b>At 31 December 2011</b>	<b>(194)</b>

The notes on pages 73 to 102 are an integral part of the combined historical financial information.

## Combined Statement of Cash Flows

\$ million	2013	2012	2011
<b>Cash flows from operating activities</b>			
Operating profit	2,155	2,038	2,020
Depreciation, amortisation and impairment	56	43	37
Post retirement benefits	18	18	20
Costs of employees' services compensated by share schemes	18	20	16
Operating cash flows before movement in working capital	2,247	2,119	2,093
Increase in inventories	(109)	(139)	(17)
Increase in trade and other receivables	(14)	(3)	(9)
Increase in trade and other payables	17	93	114
Increase in other	26	7	2
Movement in working capital	(80)	(42)	90
Taxation paid	(856)	(769)	(806)
<b>Net cash flows generated by operating activities</b>	<b>1,311</b>	<b>1,308</b>	<b>1,377</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	(50)	(73)	(56)
Purchase of intangible assets – software	(12)	(1)	—
Purchase of business, net of cash acquired	(46)	(135)	—
<b>Net cash used in investing activities</b>	<b>(108)</b>	<b>(209)</b>	<b>(56)</b>
<b>Cash flows from financing activities</b>			
Transactions with owners of the Lorillard Business	(1,203)	(1,099)	(1,321)
<b>Net cash used in financing activities</b>	<b>(1,203)</b>	<b>(1,099)</b>	<b>(1,321)</b>
<b>Net increase in cash and cash equivalents</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at start of year</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at end of year</b>	<b>—</b>	<b>—</b>	<b>—</b>

The notes on pages 73 to 102 are an integral part of the combined historical financial information.

Lorillard and its subsidiaries from time to time and, where context requires, each one of them (the **Lorillard Group**) uses a centralised approach to cash management and financing its operations. Transactions between Lorillard and the carve-out group are accounted for through invested capital. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the carve-out in this historical financial information.

## NOTES TO THE HISTORICAL FINANCIAL INFORMATION

### 1 Background to the transaction and nature of the business

#### Background to the transaction

On 15 July 2014, Reynolds, Lorillard, Inc. (**Lorillard**) and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds American Inc. (**Reynolds**), entered into an agreement and plan of merger (the **Merger Agreement**). Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will own 100 per cent. of the outstanding capital stock of Lorillard (the **Merger**).

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, LLC (formerly called Lignum-2 L.L.C.) (a wholly-owned subsidiary of Imperial) (**ITG Brands**), and Reynolds entered into an agreement (the **Asset Purchase Agreement**), pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands (and/or any one or more of Imperial's subsidiaries from time to time (the **Imperial Group**)) the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*, and the associated assets, employees, offices, production facilities and certain associated liabilities of Reynolds and Lorillard and their relevant affiliates (the **Acquired Assets**) (the **Acquisition**). Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent. (*Winston*, *Kool* and *Salem*, together with *Maverick* and, if applicable, the *Doral* brand being the **Acquired Tobacco Cigarette Brands**).

#### Nature of the business

The *Maverick* and *blu* brands, and the associated assets, properties, licences, rights, employees and certain associated liabilities which form part of the Acquired Assets and are being acquired by ITG Brands or a member of the Imperial Group as part of the Acquisition and that are owned by, or relate to, the Lorillard Group as at the date of this document are hereafter referred to as the **Lorillard Business**.

The accompanying historical financial information (the **Lorillard Business Historical Financial Information** or **Lorillard HFI**) reflects the assets, liabilities, revenues and expenses attributed to the Lorillard Business which includes the revenue earned and expenses incurred by Lorillard on those brands produced by it which are not being acquired by Imperial but which will be manufactured for Reynolds under the Reciprocal Manufacturing Agreement.

Note 4 to this Lorillard HFI discloses the split of revenue and gross profit attributable to the acquired and non-acquired brands of the Lorillard Business.

The Reynolds HFI on the Acquired Assets owned as at the date of this document by Reynolds is set out in Section B of Part 5 of this document.

### 2 Accounting Policies

#### Basis of Preparation

The Lorillard Business has not comprised a separate legal entity or group of entities for the years ended 31 December 2013, 2012 and 2011. The Lorillard HFI, which has been prepared specifically for the purpose of this document, is therefore prepared on a basis that combines the results, assets and liabilities of the Lorillard Business by applying the principles underlying the consolidation procedures of IFRS 10 'Consolidated Financial Statements' (**IFRS 10**) for each of the three years ended 31 December 2013, 2012 and 2011 and as at these dates. On such basis, the Lorillard HFI sets out the combined balance sheet as at 31 December 2013, 2012 and 2011 and the results of operations and cash flows for the three years then ended.

The Lorillard HFI has been prepared in accordance with the requirements of the Listing Rules, and in accordance with this basis of preparation. This basis of preparation describes how the Lorillard HFI has been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and the IFRS Interpretations Committee interpretations (together **IFRS**). References to "IFRS" hereafter should be construed as references to IFRS as adopted by the EU. The principal accounting policies that have been

applied to the Lorillard HFI are set out below. These policies have been consistently applied to all years presented unless otherwise stated. The Lorillard HFI has been prepared in accordance with IFRS consistent with that applied by Imperial in its 30 September 2014 financial statements.

IFRS does not provide for the preparation of combined financial information and accordingly in preparing the Lorillard HFI certain accounting conventions commonly used for the preparation of historical financial information for inclusion in investment circulars as described in the Annexure to SIR 2000 “Standards for Investment Reporting applicable to public reporting engagements on historical financial information” issued by the U.K. Auditing Practices Board have been applied.

The Lorillard HFI is presented in millions of U.S. dollars (\$) and is prepared on an historical cost and going concern basis. The planned separation of the Lorillard Business has been considered and it is expected that the appropriate funding will be available for future operations as the separation occurs. It is expected that following separation from Lorillard the Lorillard Business will continue operating. The Lorillard Business’ forecasts and projections, taking account of possible changes in trading performance show that the Lorillard Business will be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

The following summarises the accounting and other principles applied in preparing the Lorillard HFI:

The Lorillard HFI was prepared using the Lorillard Business’ historical records of its assets and liabilities, and includes all sales, costs, assets and liabilities directly attributable to the Lorillard Business. Costs directly associated with the Business, for example, the costs associated with manufacturing, are separately identifiable and have been included directly within the Lorillard HFI.

All such costs and expenses have been deemed to have been paid by the Lorillard Business to Lorillard in the period in which the costs were incurred. Invested capital in the Lorillard Business as shown in the Combined Balance Sheet includes amounts due to / from Lorillard.

Lorillard uses a centralised approach to cash management and financing its operations. Transactions between Lorillard and the Lorillard Business are accounted for through invested capital. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the Lorillard Business in the Lorillard HFI.

The income taxes charged to the Combined Income Statement have been prepared on a separate return basis as if the carve-out group was a stand-alone entity. Historically, it was included in tax filings with other group entities. It does not maintain taxes payable to/from Lorillard, and it is deemed to settle the annual current tax balances immediately with the legal taxpaying entities. These settlements are reflected as changes in invested capital.

The Acquisition does not include historical liabilities relating to tobacco litigation and associated external fees. Accordingly, management has carved out the tobacco litigation costs and provisions and related external legal fees in defending the actions from the Lorillard HFI on the basis that such claims are against Lorillard and are not brand specific. Similarly, whilst the Lorillard HFI includes estimated amounts payable under the MSA (as such term is defined in these notes), it excludes the impact of recent settlements of disputes under the MSA involving payment adjustments relating to non-participating manufacturers as these were agreed by Lorillard and are not brand specific.

### **Foreign Currency**

Items included in the Lorillard HFI of the Lorillard Business are measured using the currency of the primary economic environment in which the Lorillard Business operates (the functional currency).

The income and cash flow statements of the Lorillard Business’ subsidiaries using non-U.S. dollar functional currencies are translated to U.S. dollars (the Lorillard Business’ presentational currency) at average rates of exchange in each period. Assets and liabilities of these companies are translated at rates of exchange ruling at the balance sheet date. The differences between retained profits and losses translated at average and closing rates are taken to reserves, as are differences arising on the retranslation of the net assets at the beginning of the year.



Transactions in currencies other than the Lorillard Business' functional currency are initially recorded at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the combined income statement with exchange differences arising on trading transactions being reported in operating profit, and those arising on financing transactions being reported in net finance costs.

### **Revenue Recognition**

Revenue comprises the invoiced value for the sale of goods net of sales taxes, rebates and discounts. Revenue from the sale of goods is recognised when ownership of the goods transfers to customers and collectability of the related receivables is reasonably assured.

### **Duty and Similar Items**

Duty and similar items includes duty and levies having the characteristics of duty. In countries where duty is a production tax, duty is included in revenue and in cost of sales in the Combined income statement. Where duty is a sales tax, duty is excluded from revenue. Payments due in the U.S. under the MSA are considered to be levies having the characteristics of duty and are treated as a production tax.

### **Taxes**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Management periodically evaluates positions taken in tax returns where the applicable tax regulation is subject to interpretation and establishes provisions on the basis of amounts expected to be paid to the tax authorities only where it is considered more likely than not that an amount will be paid or received. This test is applied to each individual uncertain position which is then measured on the single most likely outcome.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the Lorillard HFI and the tax base, except if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates that have been enacted or substantively enacted at the balance sheet date, and are expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

### **Intangible Assets – Goodwill**

Goodwill represents the excess of value transferred to the seller in return for control of the acquired business together with the fair value of any previously held equity interest in that business over the Lorillard Business' share of the fair value of the identifiable net assets.

Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Any impairment is recognised immediately in the Combined Income Statement and cannot be subsequently reversed. For the purpose of impairment testing, goodwill is allocated to groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

### **Intangible Assets – Other**

Other intangible assets (which relate primarily to acquired trademarks and rights and software) are initially recognised in the Combined Balance Sheet at historical cost unless they were acquired as part of a business combination, in which case they are initially recognised at fair value. They are shown in the balance sheet at historical cost or fair value (depending on how they are acquired) less accumulated amortisation and impairment.

These assets consist mainly of acquired trademarks, intellectual property, concessions and rights, acquired customer relationships and computer software. Trademarks, intellectual property, supply agreements (including customer relationships) and computer software are amortised over their estimated useful lives as follows:

Amortizable intangible assets:

<i>blu</i> eCigs Non-compete agreement and Technology	5 years	straight line
<i>blu</i> eCigs trademark and trade-name	10 years	straight line
<i>SKYCIG</i> Non-compete agreement and Customer list	5 years	straight line
<i>SKYCIG</i> trademark and trade-name	18 months	straight line
Software	3 years	straight line

Following completion of the Acquisition intangible assets will be recognised at fair value and the estimated useful economic lives assessed. Accordingly the presented historical determination may not necessarily be reflective of Imperial's future assessment.

### **Property, Plant and Equipment**

Property, plant and equipment are shown in the Combined Balance Sheet at historical cost or fair value (depending on how they are acquired), less accumulated depreciation and impairment. Costs incurred after initial recognition are included in the assets' carrying amounts or recognised as a separate asset as appropriate only when it is probable that future economic benefits associated with them will flow to the Lorillard Business and the cost of the item can be measured reliably.

Land is not depreciated. Depreciation is provided on other property, plant and equipment so as to write down the initial cost of each asset to its residual value over its estimated useful life as follows:

Buildings	40 years	straight line
Machinery and equipment	3 – 12 years	straight line
Fixtures and motor vehicles	2 – 15 years	straight line

The assets' residual values and useful lives are reviewed and, if appropriate, adjusted at each balance sheet date.

### **Financial instruments**

Non-derivative financial assets are classified as receivables. Receivables are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. A provision for impairment of receivables is established when there is objective evidence that the Lorillard Business will not be able to collect all amounts due according to the original terms of those receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, and is recognised in the Combined Income Statement.

Non-derivative financial liabilities are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method.

### **Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost for leaf tobacco is determined using the average cost method. Cost for other inventories is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Leaf tobacco inventory which has an operating cycle that exceeds 12 months is classified as a current asset, consistent with recognised industry practice.

## **Provisions**

A provision is recognised in the Combined Balance Sheet when the Lorillard Business has a legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources will be required to settle that obligation, and a reliable estimate of the amount can be made.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

## **Retirement Benefit Schemes**

For defined benefit schemes, the amount recognised in the consolidated balance sheet is the difference between the present value of the defined benefit obligation at the balance sheet date and the fair value of the scheme assets to the extent that they are demonstrably recoverable either by refund or a reduction in future contributions. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

The service cost of providing retirement benefits to employees during the year is charged to operating profit. Past service costs are recognised immediately in operating profit, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time.

For defined contribution schemes, contributions are recognised as an employee benefit expense when they are due.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognised immediately in income.

## **Share-Based Payments**

The Lorillard Business applies the requirements of IFRS 2 Share-Based Payment Transactions to equity-settled share-based employee compensation schemes. All of the Lorillard Business' schemes are equity-settled.

Equity-settled share-based payments are measured at fair value at the date of grant and are expensed over the vesting period, based on the number of instruments that are expected to vest. Earnings per share vesting conditions are reflected in the estimate of awards that will eventually vest. Where applicable the Lorillard Business recognises the impact of revisions to original estimates in the consolidated income statement, with a corresponding adjustment to equity for equity-settled schemes. Fair values are measured using appropriate valuation models, taking into account the terms and conditions of the awards.

## **New Accounting Standards and Interpretations**

New standards or interpretations which came into effect for the current reporting period did not have a material impact on the net assets or results of the Lorillard Business.

### *Adoption of IAS 19 (revised 2011)*

The revised employee benefit standard introduces changes to the recognition, measurement, presentation and disclosure of post-employment benefits. The standard also requires net interest expense / income to be calculated as the product of the net defined benefit liability / asset and the discount rate as determined at the beginning of the year. The effect of this is to remove the previous concept of recognising an expected return on plan assets. The combined historical financial information is presented to reflect the impact of the retrospective application of IAS 19 (revised).

Other standards and interpretations issued, but not yet effective, are not expected to have a material effect on the Lorillard Business' net assets or results.

### 3 Critical Accounting Estimates and Judgements

The Lorillard Business makes estimates and assumptions regarding the future. Estimates and judgements are continually evaluated based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In the future, actual experience may deviate from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the current financial year are discussed below.

#### Legal Proceedings and Disputes

Lorillard has historically recognised provisions for tobacco-related legal claims in its consolidated financial statements for litigations made against its group companies. These legal claims are not directly attributable to specific brands and relate to periods prior to those presented in the Lorillard HFI. Additionally, the *Maverick* brand is to be acquired without historic product liabilities. An indemnity against such liabilities has also been provided by Reynolds in the Asset Purchase Agreement to take effect from completion of the Acquisition. Therefore, as there is no rational basis for allocating legal costs to the Lorillard Business, provisions for tobacco-related legal claims and the associated external legal costs have not been allocated or attributed to the Lorillard Business and are excluded from the Lorillard HFI.

The Lorillard Business reviews other outstanding legal cases following developments in the legal proceedings at each balance sheet date, considering the nature of the litigation, claim or assessment; the legal processes and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought; the progress of the case (including progress after the date of the Lorillard HFI but before those statements are issued); the opinions or views of legal counsel and other advisers; experience of similar cases; and any decision of the Lorillard Business' management as to how it will respond to the litigation, claim or assessment.

To the extent that the Lorillard Business' assessments at any time do not reflect subsequent developments or the eventual outcome of any claim, its future financial statements may be materially affected, with a favourable or adverse impact upon the Lorillard Business' operating profit, financial position and liquidity.

A summary of significant legal cases in which the Lorillard Business is currently involved is disclosed in note 17.

#### Tobacco Settlement Agreement Costs

Lorillard is also a party to the MSA and other settlements with States as further set out in these notes.

Lorillard and the other OPMs and certain SPMs under the MSA are currently involved in an arbitration with certain of the settling States with respect to the availability for certain market years of a downward adjustment to the annual MSA settlement payment obligation, known as the "NPM Adjustment".

On December 17, 2012, Lorillard and certain of the other OPMs and SPMs agreed to settle with 17 States and the District of Columbia and Puerto Rico disputes under the MSA related to the NPM Adjustment. Five additional States subsequently joined this settlement. The settlement resolves the claims for the years 2003 through 2012 and puts in place a new method for calculating this adjustment with respect to the States that signed the settlement, beginning for volume year 2013. Under the terms of the settlement, Lorillard and other manufacturers will receive credits against their future MSA payments over /six years, and the signatory states will be entitled to receive their allocable share of the amounts currently being held in escrow resulting from these disputes. Lorillard currently expects to receive credits over six years of approximately \$254 million on its outstanding claims, with \$165 million having occurred in April 2013, \$36 million in April 2014 (including \$14 million received in April 2014 related to the 2003 NPM Adjustment award from the two States that joined the settlement in June 2014), and approximately \$53 million over the following five years. The estimate is subject to change depending upon a number of factors included in the calculation of the credit.

Whilst the Lorillard HFI includes estimated amounts payable under the MSA, it excludes the impact of recent settlements of disputes under the MSA involving payment adjustments relating to non-participating manufacturers as these were agreed by Lorillard and are not brand specific.

### **Property, Plant and Equipment and Intangible Assets**

Intangible assets (other than goodwill) and property, plant and equipment are amortised or depreciated over their useful lives which are based on management's estimates of the period over which the assets will generate revenue, and are periodically reviewed for continued appropriateness. Changes to the estimates used can result in significant variations in the carrying value.

The Lorillard Business assesses the impairment of property, plant and equipment and intangible assets subject to amortisation or depreciation whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Additionally, goodwill arising on acquisitions is subject to impairment review. The Lorillard Business' management undertakes an impairment review annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review of property, plant and equipment and/or intangible assets include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of the use of the acquired assets or the strategy for the overall business; and
- significant negative industry or economic trends.

The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the Lorillard Business' accounting estimates in relation to property, plant and equipment and intangible assets affect the amounts reported in the Lorillard HFI, especially the estimates of the expected useful economic lives and the carrying values of those assets. If business conditions were different, or if different assumptions were used in the application of this and other accounting estimates, it is likely that materially different amounts could be reported in the Lorillard Business' Lorillard HFI. Current and future levels of volatility and uncertainty over economic conditions are important factors in assessing the reasonableness of these estimates, assumptions and judgements.

See notes 8 and 9 to the historical financial information.

### **Income Taxes**

The Lorillard Business is subject to income tax in numerous jurisdictions and significant judgement is required in determining the provision for tax. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Lorillard Business recognises provisions for tax based on estimates of the taxes that are likely to become due. Where the final tax outcome is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred tax provisions in the period in which such determination is made.

### **Promotional Programmes**

Retail sales incentives include retail price discounts, coupons and retail display allowances and are recorded as an expense based on amounts estimated as due to customers and consumers at the end of a period based primarily on use and redemption rates.

### **Pension and Postretirement Benefit Obligations**

The costs, assets and liabilities of the defined benefit retirement schemes operating within the Lorillard Business are determined using methods relying on actuarial estimates and assumptions. The Lorillard Business takes advice from independent actuaries relating to the appropriateness of the assumptions. It is important to note, however, that comparatively small changes in the assumptions used may have a significant effect on the Lorillard HFI. Details of the key assumptions are set out in note 15.

### **Goodwill and Intangible Assets**

The acquisitions of *blu* eCigs on April 24, 2012 and *SKYCIG* on October 1, 2013 resulted in the recording of goodwill, trademarks and other intangible assets. Upon acquisition, the purchase price was first allocated to identifiable assets and liabilities, including trademarks and trade names and other intangible assets, and the remainder of the purchase price was recorded as



goodwill. The goodwill recorded as a part of the *blu* eCigs CGU is considered to be an indefinite lived intangible asset and as such is not amortized. The *blu* eCigs trademark recorded as part of the *blu* eCIG CGU has an estimated useful life of 10 years and is being amortised over that life on a straight line basis starting in the month of acquisition. The *SKYCIG* trademark recorded as part of the *SKYCIG* CGU has an estimated useful life of 18 months and is being amortised over that life on a straight line basis starting on the date of acquisition (October 1, 2013). The *SKYCIG* goodwill, also recorded as part of the *SKYCIG* CGU, is considered an indefinite lived intangible asset. Both the *blu* eCigs and *SKYCIG* CGUs are components of the Electronic Cigarettes reporting segment. We test indefinite lived intangible assets annually or more frequently if there are any indications that impairment may have arisen.

#### 4 Segment Information

The Lorillard Business has two reportable segments, Cigarettes and Electronic Cigarettes. The Lorillard Business identifies segments based on how the Chief Operating Decision Maker (defined in IFRS 8) assesses performance and allocates resources, which is based on the types of products sold by each segment.

The function of Chief Operating Decision Maker is performed by the Chief Executive Officer, who is regularly provided with information on the two segments. This information is used as the basis of the segment revenue and profit disclosures provided below. The main profit measure used by the Chief Executive Officer is adjusted operating profit. Centrally incurred costs, such as the cost of the Lorillard Business' sales force and administrative overhead costs, are allocated to each segment based on the percentage of each segment's budgeted net sales (excluding federal excise taxes) of the Lorillard Business' consolidated net sales (excluding federal excise taxes). Segment balance sheet information is provided to the Chief Executive Officer on a total assets basis only.

The Cigarettes segment consists principally of the operations of the tobacco business and related entities. Its principal products are marketed under the brand names of *Newport*, *Kent*, *True*, *Maverick* and *Old Gold* with substantially all of its sales in the U.S.

The Electronic Cigarettes segment consists of the operations of LOEC, Inc (**LOEC**) (doing business as *blu* eCigs), Cygnet (trading as *SKYCIG* or *Blu* U.K.) and related entities. LOEC is an electronic cigarette company in the U.S., and markets its products under the *blu* eCigs brand. The Lorillard Business acquired the *blu* eCigs brand and other assets used in the manufacture, distribution, development, research, marketing, advertising and sale of electronic cigarettes on April 24, 2012. The Lorillard Business acquired certain of the assets and operations of *SKYCIG*, a United Kingdom based electronic cigarette business on October 1, 2013.

Prior to the acquisition of *blu* eCigs on April 24, 2012, the Lorillard Business managed its operations on the basis of one operating and reportable segment being Cigarettes.

Revenues of approximately \$2,273m (2012: \$2,149m; 2011: \$2,032m) are derived from a single external customer. These revenues are attributable to the cigarette segment. The Lorillard Business has no intra-group transactions between its operating segments, other than for centrally managed Legal, Compliance and Research and Development activities which totalled \$1m and \$1m in 2013 and 2012, respectively.

The Lorillard Business maintains its headquarters and manufactures all of its cigarette products at its Greensboro, North Carolina facilities. Substantially all of the Lorillard Business' sales and fixed assets are in the United States of America. *Newport*, *Kent*, *True*, *Maverick*, *Old Gold*, *blu* eCigs and *SKYCIG* are the registered trademarks of the Lorillard Group and its subsidiaries. The Lorillard Group sold its major cigarette trademarks outside of the U.S. in 1977.



\$ million	2013			2012		
	Cigarettes	e-Cigarettes	Total	Cigarettes	e-Cigarettes	Total
Revenue	7,656	244	7,900	7,460	61	7,521
Profit before taxation	2,161	(6)	2,155	2,041	(3)	2,038
– Acquisition expenses	4	—	4	5	1	6
– Amortisation of acquired brand	—	12	12	—	4	4
Adjusted profit before taxation	2,165	6	2,171	2,046	2	2,048

\$ million	2013				2012			
	Cigarettes	e-Cigarettes	Consolidating Adjustments	Total	Cigarettes	e-Cigarettes	Consolidating Adjustments	Total
Depreciation and amortisation	44	12	—	56	38	5	—	43
Additions to PPE	49	1	—	50	73	—	—	73
Total assets	1,727	291	(125)	1,893	1,556	204	(125)	1,635

The results of the Lorillard Business for the year end 31 December are presented below split between the results of the brands to be acquired by Imperial as part of the Acquisition and non-acquired brands manufactured but excluded from Imperial's Acquisition.

\$ million	2013		
	Acquired brands	Non-acquired brands	Total
Revenue	912	6,988	7,900
Duty and similar items	(493)	(3,088)	(3,581)
Other cost of sales	(218)	(438)	(656)
<b>Cost of sales</b>	<b>(711)</b>	<b>(3,526)</b>	<b>(4,237)</b>
<b>Gross profit</b>	<b>201</b>	<b>3,462</b>	<b>3,663</b>
Distribution, advertising and selling costs			(1,194)
Acquisition costs			(4)
Amortisation of acquired intangibles			(12)
Other expenses			(298)
<b>Administrative and other expenses</b>			<b>314</b>
Operating profit / Profit before taxation			2,155
Taxation			(817)
<b>Profit for the year</b>			<b>1,338</b>

\$ million	2012		
	Acquired brands	Non-acquired brands	Total
Revenue	732	6,789	7,521
Duty and similar items	(493)	(3,057)	(3,550)
Other cost of sales	(103)	(432)	(535)
<b>Cost of sales</b>	<b>(596)</b>	<b>(3,489)</b>	<b>(4,085)</b>
<b>Gross profit</b>	<b>136</b>	<b>3,300</b>	<b>3,436</b>
Distribution, advertising and selling costs			(1,103)
Acquisition costs			(6)
Amortisation of acquired intangibles			(4)
Other expenses			(285)
<b>Administrative and other expenses</b>			<b>(295)</b>
Operating profit / Profit before taxation			2,038
Taxation			(756)
<b>Profit for the year</b>			<b>1,282</b>

\$ million	2011		
	Acquired brands	Non-acquired brands	Total
Revenue	608	6,716	7,324
Duty and similar items	(466)	(3,036)	(3,502)
Other cost of sales	(65)	(422)	(487)
<b>Cost of sales</b>	<b>(531)</b>	<b>(3,458)</b>	<b>(3,989)</b>
<b>Gross profit</b>	<b>77</b>	<b>3,258</b>	<b>3,335</b>
Distribution, advertising and selling costs			(1,043)
Amortisation of acquired intangibles			(2)
Other expenses			(270)
<b>Administrative and other expenses</b>			<b>(272)</b>
Operating profit / Profit before taxation			2,020
Taxation			(756)
<b>Profit for the year</b>			<b>1,264</b>

## 5 Profit Before Taxation

Profit before taxation is stated after charging/(crediting):

\$ million	2013	2012	2011
Raw materials and consumables used	373	363	373
Operating lease charges	5	4	5
Research and development	21	20	22
Profit/(Loss) on disposal of property, plant and equipment	(1)	1	—
Write down of inventories	7	—	—
Amortisation	13	4	2
Depreciation	43	39	35
	<b>380</b>	<b>368</b>	<b>324</b>

## 6 Employees

### Employment costs

\$ million	2013	2012	2011
Wages and salaries	291	280	252
Social security costs	17	17	16
Pension and post-retirement costs	54	51	40
Share-based payments	18	20	16
	<b>380</b>	<b>368</b>	<b>324</b>

### Number of people employed by the Lorillard Business during the year

	2013	2012	2011
Average	2,900	2,900	2,800

### Key management compensation

Key management includes directors (executive and non-executive) and named executive officers. Certain members of key management will not transfer to Imperial on completion of the Acquisition. The compensation paid or payable to key management for employee services is shown below:

\$ million	2013	2012	2011
Salaries and other short-term employee benefits	13	10	12
Post-employment benefits	—	1	2
Non-employee Director Cash Compensation	1	1	1
Share-based payments	10	9	14
<b>Total</b>	<b>24</b>	<b>21</b>	<b>29</b>

## 7 Taxation

### Analysis of charge in the year

\$ million	2013	2012	2011
Current tax			
Federal	682	630	658
State and other	174	139	148
<b>Total current tax</b>	<b>856</b>	<b>769</b>	<b>806</b>
Deferred tax			
Federal	(24)	(10)	(39)
State and other	(15)	(3)	(11)
<b>Total deferred tax</b>	<b>(39)</b>	<b>(13)</b>	<b>(50)</b>
<b>Total tax charged to the Combined income statement</b>	<b>817</b>	<b>756</b>	<b>756</b>

The income taxes charged to the Combined Income Statement have been prepared on a separate return basis as if the Lorillard Business was a stand-alone entity. Historically, the Lorillard Business was included in tax filings with other group entities. The Lorillard Business does not maintain taxes payable to/from Lorillard, and the Lorillard Business is deemed to settle the annual current tax balances immediately with the legal taxpaying entities. These settlements are reflected as changes in invested capital.

### Factors affecting the tax charge for the year

The tax on the Lorillard Business' profit before tax differs from the theoretical amount that would arise using the average U.S. federal income tax rate for the year of 35 per cent. (2012: 35 per cent., 2011: 35 per cent.) as follows:

\$ million	2013	2012	2011
<b>Profit before tax</b>	<b>2,155</b>	<b>2,038</b>	<b>2,020</b>
Tax at the U.S. corporate tax rate of 35%	754	713	707
Tax effects of:			
State tax, net of federal effect	104	89	89
Differences in effective tax rates on overseas earnings	1	—	—
Permanent differences	(42)	(46)	(40)
<b>Total tax charged to the Combined income statement</b>	<b>817</b>	<b>756</b>	<b>756</b>

## 8 Intangible Assets

	2013			
\$ million	Goodwill	Trademarks	Software	Total
<b>Cost</b>				
At 1 January 2013	64	57	80	201
Additions (note 18)	38	36	12	86
At 31 December 2013	<b>102</b>	<b>93</b>	<b>92</b>	<b>287</b>
<b>Amortisation</b>				
At 1 January 2013	—	4	78	82
Amortisation charge for the year	—	12	1	13
At 31 December 2013	<b>—</b>	<b>16</b>	<b>79</b>	<b>95</b>
<b>Net book value</b>				
At 31 December 2013	<b>102</b>	<b>77</b>	<b>13</b>	<b>192</b>

	2012			
\$ million	Goodwill	Trademarks	Software	Total
<b>Cost</b>				
At 1 January 2012	—	—	79	79
Additions (note 18)	64	57	1	122
At 31 December 2012	<b>64</b>	<b>57</b>	<b>80</b>	<b>201</b>
<b>Amortisation</b>				
At 1 January 2012	—	—	78	78
Amortisation charge for the year	—	4	—	4
At 31 December 2012	<b>—</b>	<b>4</b>	<b>78</b>	<b>82</b>
<b>Net book value</b>				
At 31 December 2012	<b>64</b>	<b>53</b>	<b>2</b>	<b>119</b>

	2011			
\$ million	Goodwill	Trademarks	Software	Total
<b>Cost</b>				
At 1 January 2011	—	—	79	79
Additions (note 18)	—	—	—	—
At 31 December 2011	<b>—</b>	<b>—</b>	<b>79</b>	<b>79</b>
<b>Amortisation</b>				
At 1 January 2011	—	—	76	76
Amortisation charge for the year	—	—	2	2
At 31 December 2011	<b>—</b>	<b>—</b>	<b>78</b>	<b>78</b>
<b>Net book value</b>				
At 31 December 2011	<b>—</b>	<b>—</b>	<b>1</b>	<b>1</b>

Trademarks principally comprise brands acquired through the purchases of *blu* eCigs and *SKYCIG*. See note 18.

Intangible amortisation is included within administrative and other expenses in the Combined income statement.

#### Goodwill and intangible asset impairment review

Goodwill is allocated to groups of cash-generating units (CGUs) that are expected to benefit from the business combination in which the goodwill arose. Goodwill is allocated to the *blu* eCigs and *SKYCIG* CGUs, which are components of the e-cigarettes segment. A summary of the carrying value of goodwill is set out below.

\$ million	2013 Goodwill	2012 Goodwill	2011 Goodwill
<i>blu</i> eCigs	64	64	—
<i>SKYCIG</i>	38	—	—

**Goodwill has arisen on the acquisitions of *blu* eCigs and *SKYCIG*. See note 18.**

The Lorillard Business tests goodwill for impairment annually, or more frequently if there are any indications that impairment may have arisen. The value of a CGU, or group of CGUs as appropriate, is based on value-in-use calculations. These calculations use cash flow projections

derived from a nine year financial plan for *blu* eCigs and an eight year financial plan for *SKYCIG* which are approved by management annually and are based on detailed bottom-up market-by-market forecasts of projected sales volumes for each product line. The financial plan for *blu* eCigs and *SKYCIG* is based on management's formally approved five year business plan, extended to reflect the rapid growth of the e-cigarettes market and management's expectation that significant growth will occur over a period greater than five years. These forecasts reflect, on an individual market basis, numerous assumptions and estimates regarding anticipated changes in market size, prices and duty regimes, consumer preferences and other changes in product mix, based on long- term market trends, market data, anticipated regulatory developments, and management experience and expectations. We consider that pricing, market size, market shares and cost inflation are the key assumptions used in our plans.

#### **Growth rates and discount rates used**

The compound annual revenue growth rate implicit in the value-in-use calculations was 36 per cent. for *blu* eCigs and 20 per cent. for *SKYCIG* (2012: 73 per cent for *blu* eCigs, n/a for *SKYCIG*; 2011: n/a).

Estimated long-term weighted average compound annual revenue growth rates of 2 per cent. per annum are used beyond year nine for *blu* eCigs and year eight for *SKYCIG* and are based on management's long-term expectations taking into account industry specific factors.

Discount rates used are based on the Lorillard Business' weighted average cost of capital adjusted for the different risk profiles of the CGUs. The pre-tax discount rate was 15.7 per cent. for *blu* eCigs and 13.9 per cent. for *SKYCIG* (2012: 16.3 per cent. for *blu* eCigs and n/a for *SKYCIG*, 2011: n/a).

Our impairment projections are prepared under the basis set out in IAS 36 which can differ from our internal plans.

Any reasonable movement in the assumptions used in the impairment tests would not result in an impairment.

## **9 Property, Plant and Equipment**

<b>\$million</b>	<b>2013</b>			
	<b>Property</b>	<b>Plant and equipment</b>	<b>Fixtures and motor vehicles</b>	<b>Total</b>
<b>Cost</b>				
At 1 January 2013	98	523	54	675
Additions	10	34	6	50
Disposals	—	(25)	(1)	(26)
At 31 December 2013	<b>108</b>	<b>532</b>	<b>59</b>	<b>699</b>
<b>Depreciation and impairment</b>				
At 1 January 2013	64	270	44	378
Depreciation charge for the year	1	35	7	43
Disposals	—	(22)	(3)	(25)
At 31 December 2013	<b>65</b>	<b>283</b>	<b>48</b>	<b>396</b>
<b>Net book value</b>				
At 31 December 2013	<b>43</b>	<b>249</b>	<b>11</b>	<b>303</b>



	2012			
<b>\$million</b>	<b>Property</b>	<b>Plant and equipment</b>	<b>Fixtures and motor vehicles</b>	<b>Total</b>
<b>Cost</b>				
At 1 January 2012	93	468	50	611
Additions	5	65	5	75
Disposals	—	(10)	(1)	(11)
At 31 December 2012	<b>98</b>	<b>523</b>	<b>54</b>	<b>675</b>
<b>Depreciation and impairment</b>				
At 1 January 2012	62	246	42	350
Depreciation charge for the year	2	33	4	39
Disposals	—	(9)	(2)	(11)
At 31 December 2012	<b>64</b>	<b>270</b>	<b>44</b>	<b>378</b>
<b>Net book value</b>				
At 31 December 2012	<b>34</b>	<b>253</b>	<b>10</b>	<b>297</b>

	2011			
<b>\$million</b>	<b>Property</b>	<b>Plant and equipment</b>	<b>Fixtures and motor vehicles</b>	<b>Total</b>
<b>Cost</b>				
At 1 January 2011	92	446	48	586
Additions	1	51	4	56
Disposals	—	(29)	(2)	(31)
At 31 December 2011	<b>93</b>	<b>468</b>	<b>50</b>	<b>611</b>
<b>Depreciation and impairment</b>				
At 1 January 2011	60	238	45	343
Depreciation charge for the year	2	30	3	35
Disposals	—	(22)	(6)	(28)
At 31 December 2011	<b>62</b>	<b>246</b>	<b>42</b>	<b>350</b>
<b>Net book value</b>				
At 31 December 2011	<b>31</b>	<b>222</b>	<b>8</b>	<b>261</b>

Included within Property, Plant and Equipment are assets in the course of construction of US\$37 million (2012: US\$40 million and 2011: US\$ 35 million) for which no depreciation has been charged.

## 10 Inventories

\$ million	2013	2012	2011
Raw materials	588	534	423
Work in progress	7	3	1
Finished inventories	169	118	77
	<b>764</b>	<b>655</b>	<b>501</b>

It is generally recognised industry practice to classify leaf tobacco inventory as a current asset although part of such inventory, because of the duration of the processing cycle, ordinarily would not be consumed within one year. We estimate that around US\$247 million (2012: US \$238 million, 2011: US\$227 million) of leaf tobacco held within raw materials will not be utilised within a year of the balance sheet date.

## 11 Trade and Other Receivables

\$ million	2013	2012	2011
Amounts due within one year:			
Trade receivables	22	20	12
Less: provision for impairment of receivables	(3)	(3)	(2)
<b>Net trade receivables</b>	<b>19</b>	<b>17</b>	<b>10</b>
Other receivables	29	21	17
Prepayments and accrued income	24	20	25
	<b>72</b>	<b>58</b>	<b>52</b>

Trade receivables may be analysed as follows:

\$ million	2013	2012	2011
Within credit terms	19	17	10
Amounts that are impaired	3	3	2
	<b>22</b>	<b>20</b>	<b>12</b>

The carrying amount of trade and other receivables is a reasonable approximation to their fair value.

## 12 Trade and Other Payables

\$ million	2013	2012	2011
Trade payables	42	39	32
Tobacco settlement accruals	1,228	1,183	1,151
Other taxes, duties and social security contributions	62	71	58
Accruals and deferred income	192	210	165
	<b>1,524</b>	<b>1,503</b>	<b>1,406</b>

The carrying amount of trade and other payables is a reasonable approximation to their fair value.

### 13 Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the Combined Balance Sheet.

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Deferred tax assets	573	577	557
Deferred tax liabilities	(69)	(80)	(72)
	<b>504</b>	<b>497</b>	<b>485</b>

#### Deferred tax expected to be recovered within 12 months

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Deferred tax assets	529	543	530
Deferred tax liabilities	—	—	—
	<b>529</b>	<b>543</b>	<b>530</b>

#### Deferred tax assets

	<b>2013</b>			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2013	1	34	542	577
Credited to combined income statement	—	21	7	28
Charged to other comprehensive income	—	(32)	—	(32)
At 31 December 2013	<b>1</b>	<b>23</b>	<b>549</b>	<b>573</b>

	<b>2012</b>			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2012	1	27	529	557
Credited to combined income statement	—	8	13	21
Charged to other comprehensive income	—	(1)	—	(1)
At 31 December 2012	<b>1</b>	<b>34</b>	<b>542</b>	<b>577</b>

	2011			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2011	1	—	482	483
Credited to Combined income statement	—	5	47	52
Credited to other comprehensive income	—	22	—	22
At 31 December 2011	<b>1</b>	<b>27</b>	<b>529</b>	<b>557</b>

Temporary differences primarily arise on the timing of the tax deduction for the MSA accrual.

#### Deferred tax liabilities

	2013			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2013	(64)	—	(16)	(80)
Credited/(charged) to Combined income statement	(5)	—	16	11
At 31 December 2013	<b>(69)</b>	<b>—</b>	<b>—</b>	<b>(69)</b>

	2012			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2012	(57)	—	(15)	(72)
Charged to Combined income statement	(7)	—	(1)	(8)
At 31 December 2012	<b>(64)</b>	<b>—</b>	<b>(16)</b>	<b>(80)</b>

	2011			
<b>\$ million</b>	<b>Fixed and intangible assets</b>	<b>Retirement benefits</b>	<b>Other temporary differences</b>	<b>Total</b>
At 1 January 2011	(52)	(4)	(14)	(70)
Credited/(charged) to Combined income statement	(5)	4	(1)	(2)
At 31 December 2011	<b>(57)</b>	<b>—</b>	<b>(15)</b>	<b>(72)</b>

## 14 Provisions

\$ million	2013	2012	2011
At 1 January	—	—	—
Additional provisions arising from business combination (see note 18)	(25)	—	—
Other charged to income statement	(2)	—	—
At 31 December	<u>(27)</u>	<u>—</u>	<u>—</u>
Analysed as:			
\$ million	2013	2012	2011
Current	—	—	—
Non-current	(27)	—	—
	<u>(27)</u>	<u>—</u>	<u>—</u>

Provisions relate primarily to the earn out liability arising on the acquisition of *SKYCIG*. See note 18.

## 15 Retirement Benefit Schemes

The Lorillard Business has defined benefit and defined contribution pensions, post-retirement benefits, profit sharing and savings plans for eligible employees.

Historically, Lorillard Group has had two defined benefit pension schemes:

- The Salaried Pension Plan provides benefits based on employees' compensation and service. The Salaried Pension Plan is not included in the Acquisition and accordingly the related net liability has been excluded from the balance sheet of this carve out combined historical financial information; and
- The Hourly Pension Plan provides benefits based on fixed amounts for each year of service. The Hourly Pension Plan is included in the Acquisition and accordingly the related net asset has been included on the balance sheet of this carve out combined historical financial information.

Lorillard Group also provides medical and life insurance benefits to eligible employees, across two schemes (the 'Salaried and Hourly post-employment medical plans'). The benefits for those employees who are transferring with the Lorillard Business are included in the Acquisition and accordingly the related net liability has been included on the balance sheet of this carve out combined historical financial information. The benefits for those employees who are not transferring with the Lorillard Business are not included in the Acquisition and accordingly the related net liability has not been included on the balance sheet of this carve out combined historical financial information.

The Lorillard Business also provides certain senior level management employees with nonqualified, unfunded supplemental retirement plans. While these plans are unfunded, the Lorillard Business has certain assets invested in an executive life insurance policy that are to be used to provide for certain of these benefits.

The full charge for all schemes, acquired and non-acquired, are reflected in the income statement of the Lorillard Business.

The results of the most recent actuarial valuations have been updated to 31 December 2013 by independent qualified actuaries in order to determine the amounts to be included in the combined financial information. The Lorillard Business uses a December 31 measurement date for its plans.

The amounts recognised in the balance sheet are determined as follows:

**Defined benefit schemes – amounts recognised in the combined balance sheet**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Present value of funded obligations	(497)	(543)	(523)
Fair value of scheme assets	552	542	520
Surplus/(Deficit) of funded plans	55	(1)	(3)
Present value of unfunded obligations	(108)	(110)	(91)
<b>Total deficit of defined retirement benefit plans</b>	<b>(53)</b>	<b>(111)</b>	<b>(94)</b>

The movement in the defined benefit obligation over the year is as follows:

**Acquired retirement benefits**

	<b>2013</b>			<b>2012</b>			<b>2011</b>		
<b>Balance Sheet and Income Statement Expense</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Total</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Total</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Total</b>
<b>Amounts recognised on the balance sheet at beginning of period</b>	<b>(652)</b>	<b>541</b>	<b>(111)</b>	<b>(614)</b>	<b>520</b>	<b>(94)</b>	<b>(539)</b>	<b>530</b>	<b>(9)</b>
<b>Income statement expense</b>									
Current service cost	(15)	—	(15)	(13)	—	(13)	(11)	—	(11)
Past service cost	—	—	—	(1)	—	(1)	(9)	—	(9)
Net (Interest) / Income on Net Defined Benefit (Liability)/ Asset	(24)	20	(4)	(28)	23	(5)	(28)	27	(1)
<b>Cost Recognised in income statement</b>	<b>(39)</b>	<b>20</b>	<b>(19)</b>	<b>(42)</b>	<b>23</b>	<b>(19)</b>	<b>(48)</b>	<b>27</b>	<b>(21)</b>
<b>Remeasurements</b>									
Actuarial Gain/(Loss) due to Liability Experience	53	—	53	(31)	—	(31)	(62)	—	(62)
Return on Plan Assets Greater/(Less) than Discount Rate	—	24	24	—	33	33	—	(2)	(2)
<b>Remeasurement Effects Recognised in OCI</b>	<b>53</b>	<b>24</b>	<b>77</b>	<b>(31)</b>	<b>33</b>	<b>2</b>	<b>(62)</b>	<b>(2)</b>	<b>(64)</b>
<b>Cash</b>									
Benefits paid directly by the company	—	—	—	—	—	—	—	—	—
Benefits paid from plan assets	34	(34)	—	35	(35)	—	35	(35)	—
<b>Net Cash</b>	<b>34</b>	<b>(34)</b>	<b>—</b>	<b>35</b>	<b>(35)</b>	<b>—</b>	<b>35</b>	<b>(35)</b>	<b>—</b>
<b>Amounts recognised on the balance sheet at end of period</b>	<b>(604)</b>	<b>551</b>	<b>(53)</b>	<b>(652)</b>	<b>541</b>	<b>(111)</b>	<b>(614)</b>	<b>520</b>	<b>(94)</b>



Total amounts recognised in the income statement in the year are as follows:

**Total amounts recognised in the combined income statement**

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Cost recognised in respect of acquired retirement benefits	19	18	21
Cost recognised in respect of non-acquired retirement benefits	30	28	14
Cost recognised in respect of defined contribution benefit plan	5	5	5
<b>Total charge recognised within administrative and other expenses</b>	<b>54</b>	<b>51</b>	<b>40</b>

**Defined benefit scheme – principal actuarial assumptions used in scheme valuations**

<b>2013</b>		
	<b>Pension benefits</b>	<b>Other post-retirement benefits</b>
%		
Discount rate	4.7	4.7
Inflation	—	2.5
<b>2012</b>		
	<b>Pension benefits</b>	<b>Other post-retirement benefits</b>
%		
Discount rate	3.9	4.0
Inflation	—	2.5
<b>2011</b>		
	<b>Pension benefits</b>	<b>Other post-retirement benefits</b>
%		
Discount rate	4.7	4.8
Inflation	—	3.5

Assumptions regarding future mortality experience are set based on advice that uses published statistics and experience, and are provided in the table below. The average life expectancy, in years, of a pensioner retiring at age 65 is as follows:

<b>2013</b>			
<b>Pension benefits</b>		<b>Other post-retirement benefits</b>	
<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
Life expectancy at age 65 years:			
Member currently aged 65	18.4	18.4	20.5
Member currently aged 50	18.4	18.4	20.5

	2012			
	Pension benefits		Other post-retirement benefits	
	Male	Female	Male	Female
Life expectancy at age 65 years:				
Member currently aged 65	18.4	20.4	18.4	20.4
Member currently aged 50	18.4	20.4	18.4	20.4

	2011			
	Pension benefits		Other post-retirement benefits	
	Male	Female	Male	Female
Life expectancy at age 65 years:				
Member currently aged 65	19.0	20.9	19.0	20.9
Member currently aged 50	19.0	20.9	19.0	20.9

Assumed health care cost trend rates for the hourly post-employment medical plan is as follows:

	2013	2012	2011
Pre-65 healthcare cost trend rate assumed for next year	8.0%	8.5%	9.0%
Post-65 healthcare cost trend rate assumed for next year	6.0%	6.0%	8.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.5%	4.5%	5.0%
Year that the rate reaches the ultimate trend rate: Pre-65	2021	2021	2020
Year that the rate reaches the ultimate trend rate: Post-65	2021	2021	2018

The sensitivity of the defined benefit obligations to changes in the weighted principal assumptions are:

Defined benefit pension plan	Changes in assumption	Increase in assumption	Decrease in assumption
Discount rate	0.25%	Decrease by 2.5%	Increase by 2.4%
<b>Salaried post-employment medical plan</b>			
Discount rate	0.25%	Decrease by 3.2%	Increase by 3.4%
Inflation	0.25%	Increase by 0.1%	Decrease by 0.1%
<b>Hourly post-employment medical plan</b>			
Discount rate	0.25%	Decrease by 3.4%	Increase by 3.5%
Health care trend increases	0.25%	Increase by 2.6%	Decrease by 2.5%
Inflation	0.25%	Increase by 0.2%	Decrease by 0.2%
Life expectancy		Increase by 1 year in assumption	Decrease by 1 year in assumption
Defined benefit pension plan		Increase by 4.3%	Decrease by 4.5%
Salaried post-employment medical plan		Increase by 2.2%	Decrease by 2.3%
Hourly post-employment medical plan		Increase by 0.7%	Decrease by 0.8%

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (present value of the defined benefit

obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension liability recognised within the statement of financial position.

The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

#### Categories of scheme assets

2013				
Pension benefits				
Fair value				Percentage of assets %
Quoted	Unquoted	Total		
\$ million				
Equities	7	126	133	24.2%
Bonds	—	163	163	29.6%
Property	—	3	3	0.5%
Other	—	252	252	45.7%
	7	544	551	100.0%
2012				
Pension benefits				
Fair value				Percentage of assets %
Quoted	Unquoted	Total		
\$ million				
Equities	25	117	142	26.3%
Bonds	121	81	202	37.3%
Property	—	4	4	0.7%
Other	—	193	193	35.7%
	146	395	541	100.0%
2011				
Pension benefits				
Fair value				Percentage of assets %
Quoted	Unquoted	Total		
\$ million				
Equities	28	118	146	28.1%
Bonds	208	—	208	40.0%
Property	—	1	1	0.2%
Other	—	165	165	31.7%
	236	284	520	100.0%

#### Scheme valuation and contribution levels

Through its defined benefit pension plans and post-employment medical plans, the Lorillard Business is exposed to a number of risks, the most significant of which are discount rate applied, the trend in healthcare costs and estimated mortality rates.

The Lorillard Business expects to contribute \$nil to its pension plan and \$1 million to its other postretirement benefit plans in 2014.

The general principles guiding the investment of the plan assets are embodied in the Employee Retirement Income Security Act of 1974 (ERISA). These principles include discharging the Lorillard Business' investment responsibilities for the exclusive benefit of plan participants and in accordance with the "prudent expert standards" and other ERISA rules and regulations. Investment objectives for the Lorillard Business' pension plan assets are to optimize the long-term return on plan assets while maintaining an acceptable level of risk, to diversify assets among asset classes and investment styles, and to maintain a long-term focus.

The plan is managed using a Liability Driven Investment (LDI) framework which focuses on achieving the plan's return goals while assuming a reasonable level of funded status volatility.

Based on this LDI framework the asset allocation has two primary components. The first component of the asset allocation is the "hedging portfolio" which uses the plan's fixed income portfolio to hedge a portion of the interest rate risk associated with the plan's liabilities, thereby reducing the plan's expected funded status volatility. The second component is the "growth/equity portfolio" which is designed to enhance portfolio returns. The growth portfolio is broadly diversified across the following asset classes: Global Equities, Long Short Equities, Absolute Return Hedge Funds, Private Equity (including growth equity, buyouts, and other illiquid assets designed to enhance returns), and Private Real Assets. Alternative investments, including hedge funds, are used judiciously to enhance risk adjusted long-term returns while improving portfolio diversification. Overlay derivatives are used to assist in the rebalancing of the total portfolio to the strategic asset allocation. Derivatives may be used to gain market exposure in an efficient and timely manner. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies, and quarterly investment portfolio reviews.

The weighted average durations of the defined benefit pension plan, hourly post-employment medical plan and salaried post-employment medical plan are 9.88, 12.97 and 12.82 years, respectively.

Expected maturity analysis of undiscounted pension and post-employment medical benefits:

<b>\$ million at 31 December 2013</b>	<b>Less than a year</b>	<b>Between 1-2 years</b>	<b>Between 2-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Pension benefits	36	36	111	182	365
Post-employment medical benefits	1	2	11	242	256
<b>Total</b>	<b>37</b>	<b>38</b>	<b>122</b>	<b>424</b>	<b>621</b>

## 16 Commitments

### Capital commitments

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Contracted but not provided for:</b>			
Property, plant and equipment and software	61	69	78

### Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases consist of leases where payments fall due:

<b>\$ million</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Property</b>			
Within one year	2	2	2
Between one and five years	4	2	1
	<b>6</b>	<b>4</b>	<b>3</b>

### Settlement of State Reimbursement Litigation

On November 23, 1998, Lorillard Tobacco, Philip Morris Incorporated, Brown & Williamson Tobacco Corporation and R.J. Reynolds Tobacco Company (the **Original Participating Manufacturers** or **OPMs**) entered into the Master Settlement Agreement (**MSA**) with 46 States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands to settle the asserted and unasserted health care cost recovery and certain other claims of those States. These settling entities are generally referred to as the “Settling States.” The Original Participating Manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota, which together with the MSA are referred to as the “State Settlement Agreements.”

The State Settlement Agreements provide that the agreements are not admissions, concessions or evidence of any liability or wrongdoing on the part of any party, and were entered into by the Original Participating Manufacturers to avoid the further expense, inconvenience, burden and uncertainty of litigation. The Lorillard Business recorded pretax charges for its obligations under the State Settlement Agreements of \$1.379 billion and \$1.411 billion for the years ended December 31, 2012 and 2013, respectively. The Lorillard Business’ portion of ongoing adjusted settlement payments and legal fees is based on its share of domestic cigarette shipments in the year preceding that in which the payment is due. Accordingly, the Lorillard Business records its portions of ongoing adjusted settlement payments as part of cost of manufactured products sold as the related sales occur.

The State Settlement Agreements require that the OPMs make annual payments of \$10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs’ attorneys’ fees, subject to an annual cap of \$500 million, and were required to pay an additional amount of up to \$125 million in each year through 2008. These payment obligations are the several and not joint obligations of each OPM. The State Settlement Agreements also include provisions relating to significant advertising and marketing restrictions, public disclosure of certain industry documents (now lapsed), limitations on challenges to tobacco control and underage use laws, and other provisions.

From time to time, lawsuits have been brought against Lorillard Tobacco and other participating manufacturers to the MSA, or against one or more of the Settling States, challenging the validity of the MSA on certain grounds, including as a violation of the antitrust laws.

In addition, in connection with the MSA, the Original Participating Manufacturers entered into an agreement to establish a US\$5.2 billion trust fund payable between 1999 and 2010 to compensate the tobacco growing communities in 14 states (the **Trust**). Payments to the Trust ended in 2005 as a result of an assessment imposed under a federal law, enacted in 2004, repealing the federal supply management program for tobacco growers. Under the law, tobacco quota holders and growers will be compensated over 10 years with payments totalling \$10.1 billion, funded by an assessment on tobacco manufacturers and importers. Payments under the law to qualifying tobacco quota holders and growers commenced in 2005 and completed in 2014. The Lorillard Business recorded pretax charges for its obligations under the law of US\$120 million, US\$118 million and US\$120 million for the years ended December 31, 2011, 2012 and 2013, respectively. It is estimated the remaining cash payments in 2014 under the law will be between \$75 million and \$80 million.

The Lorillard Business believes that the State Settlement Agreements will materially adversely affect its cash flows and operating income in future years. The degree of the adverse impact will depend, among other things, on the rates of decline in domestic cigarette sales in the premium price and discount price segments, the Lorillard Business’ share of the domestic premium price and discount price cigarette segments, and the effect of any resulting cost advantage of manufacturers not subject to significant payment obligations under the State Settlement Agreements.

### Electronic Cigarette Matters

On 7 April 2014, LOEC filed a complaint for declaratory judgment of trademark non-infringement against Zippmark, Inc. (**Zippmark**) and Zippo Manufacturing Company (**ZMC**) (together **Zippo**) in the United States District Court for the Central District of California. The lawsuit was predicated by Zippmark's decision to file oppositions with the United States Patent and Trademark Office's Trademark Trial and Appeal Board against Lorillard Technologies, Inc.'s (**LTI**) applications to register certain trademarks for BLU and allegations that Lorillard infringed several of Zippo's registered trademarks. On May 19, 2014, Zippo filed an answer and counterclaim for trademark infringement. Zippo's counterclaim is for, amongst other things, injunctive relief, treble damages and an accounting of profits (unspecified sums), attorneys fees and costs. On 12 June 2014, LOEC filed its answer to Zippo's counterclaim and filed its own counterclaim seeking to cancel certain Zippo trademarks based on descriptiveness and for false/fraudulent registration. On 7 July 2014, Zippo responded to LOEC's counterclaim and included a counterclaim in reply seeking to cancel LTI's registered trademark for BLU ECIGS. On 28 July 2014, LOEC filed an answer to Zippmark's counterclaim in reply for cancellation of LTI's registered trademark. On 11 August 2014, LTI filed its answer to Zippmark's counterclaim in reply for cancellation of its registered trademark. According to the minutes of a scheduling conference dated 21 July 2014, the cut-off date for discovery is set for 22 January 2015. The trial date is scheduled for 21 April 2015.

On 14 and 18 July 2014, ZMC filed three applications with the UK Intellectual Property Office (**UK IPO**) to declare invalid three International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK in class 34 and owned by LTI. On 29 August 2014, Cygnet UK Trading Ltd (**Cygnet**), a subsidiary of Lorillard, and LTI filed a claim against ZMC for: (a) groundless threats of infringement proceedings; and (b) declarations of non-infringement with respect to ZMC's Community Trade Mark numbers 004629689 and 005232211, and any other ZMC trade mark which incorporates the word "BLU" or any word or logo immaterially different to it. Lorillard issued a press release on 3 September 2014 in relation to this claim entitled "Lorillard Subsidiaries Sue Zippo in the UK to Stop Unfounded Threats Against BLU ECIGS". On 6 October 2014, LTI filed its notices of defence and counterstatement with the UK IPO with respect to its International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK. On 22 October 2014, ZMC entered a defence to Cygnet and LTI's claim denying that it had made a groundless threat, and served a counterclaim alleging Cygnet's and LTI's use of the various *blu* marks infringed ZMC's Community Trade Marks. ZMC's counterclaim is for, amongst other things, injunctive relief, damages or an accounting of profits, and costs. On 19 November 2014, Cygnet and LTI filed its defence denying infringement of the Community Trade Marks and served a counterclaim to revoke those Community Trade Marks for non-use and/or invalidate the Community Trade Marks due to the fact that they are devoid of distinctive character, descriptive of the products in relation to which they are registered and, or in the alternative, are deceptive in relation to certain of the products in relation to which they are registered. On 10 December 2014, ZMC filed its defence to Cygnet and LTI's counterclaim, denying that its Community Trade Marks are or were at any material time invalid.

On 15 April 2014, ZMC filed oppositions against CTM Application Nos. 12592572 *blu* eCIGS (stylised) and 12580651 BLU owned by LTI. ZMC has based its oppositions on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device.

On 22 June 2014, ZMC filed cancellation actions in Austria in relation to LTI's International Registrations numbers WO0000001051365, WO0000001058275 and WO0000001051607. No proceedings have been served on LTI.

On 22 August 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140613A BLU owned by LTI. On 28 November 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140614A *blu* eCIGS (stylised) owned by LTI. ZMC has based its opposition on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device.

On 6 August 2014, ZMC obtained a preliminary injunction from the District Court of Frankfurt am Main against Cygnet UK Trading Ltd., on the basis of ZMC's Community Trademarks for BLU. The injunction was served on Cygnet UK Trading Ltd. on 26 November 2014. Cygnet UK Trading Ltd. is complying with the injunction and has ceased selling BLU e-cigarettes and related products in Germany.



On 7 May 2014 (issued on 25 August 2014), ZMC filed at the Trademark Appeal Board of the State Administration for Industry and Commerce of the People's Republic of China three applications for the invalidation of LTI's *blu* eCIGS (stylised) trademark with International Registration number 1058275, BLU ECIGS trademark with International Registration number 1051365 and BLU CIGS trademark with International Registration number 1051607 registered in class 34. With respect to International Registration No. 1051365 BLU ECIGS, ZMC has argued that LTI disclaimed of the word "ECIGS" and as a result the distinctive part of the mark must be constrained to "BLU". On 30 September 2014, LTI filed its defence to the three invalidity actions against International Registration Nos. 1058275, 1051365 & 1051607. On 14 November 2014, LTI filed non-use cancellation proceedings against ZMC's registration Nos. 4912199 and 6131784 in Class 34 and 6131785 and 6131786 in Class 4 for BLU & Device.

Zippo has opposed LTI's Canadian Trade-mark Application No. 1501523 for the mark BLU ECIGS & Design on the basis of prior rights and likelihood of confusion. Zippo cross-examined LTI's President and LOEC's Vice President of Marketing on 12 November 2014 and the transcript is required to be filed by 23 January 2015.

### Defences

Each of Lorillard Tobacco and Lorillard, Inc. believes that it has defences to the above cases pending against it as well as bases for appeal should any adverse verdicts be returned against either of them.

### Other Litigation

LOEC, Inc. is also a defendant in four lawsuits filed on 22 June 2012, 5 March 2014, 21 October 2014, and 2 December 2014 by Ruyan Investment (Holdings) Limited and its successor companies, Fontem Ventures and Fontem Holdings 1 B.V., both companies being owned and controlled by the Imperial Group in the United States District Court for the Central District of California, alleging infringement of certain patents owned by Fontem Holdings 1 B.V. and exclusively licensed to Fontem Ventures related to electronic cigarette technology. The first case filed 22 June 2012 has been stayed pending proceedings before the United States Patent and Trademark Office. The second case filed 5 March 2014 is currently stayed. The third and fourth cases filed 21 October 2014 and 2 December 2014 have not yet been served on LOEC. No provision for this action has been made in these financial statements due to the current status of the claim (stayed) and the fact that the counter-party is a subsidiary of the Imperial Group.

Lorillard is also party to other litigation arising in the ordinary course of business. The outcome of this other litigation will not, in the opinion of management, materially affect Lorillard's results of operations or invested capital.

## 18 Acquisitions

On 24 April 2012, the Lorillard Group, through its wholly owned subsidiary, Lorillard Holdings Company, Inc. (LHCI), and its subsidiaries acquired *blu* eCigs and other assets used in the manufacture, distribution, development, research, marketing, advertising, and sale of electronic cigarettes for \$135 million in cash. This gave rise to goodwill of \$64 million which is attributable to acquired customer base and economies of scale expected from combining the operations of the Lorillard Business. The acquisition was made pursuant to an asset purchase agreement (the **Agreement**) with BLEC, LLC, Intermark Brands, LLC and QSN Technologies, LLC (the **Sellers**). The Agreement contains customary representations, warranties, covenants and indemnities by the Sellers and LHCI. This acquisition provided Lorillard with the *blu* eCigs brand and an electronic cigarette product line.

The results of operations of *blu* eCigs are included in our consolidated Lorillard HFI beginning as of 24 April 2012. The Lorillard Business' consolidated revenues include \$244 million and \$63 million of sales of *blu* eCigs during the years ended 2013 and 2012, respectively. *blu* eCigs had operating income of \$1 million and an operating loss of \$3 million during the years ended, 2013 and 2012, respectively. The Lorillard Business incurred \$6 million of acquisition-related expenses during 2012, recorded in Administrative and other expenses in the Income Statement.

The fair values of the assets acquired and liabilities assumed at the date of acquisition are summarised below (in millions):

<b>Assets acquired:</b>	<b>\$ million</b>
Current assets:	
Accounts receivable	2
Inventories	15
<b>Total current assets</b>	<b>17</b>
Goodwill	64
Intangible assets	58
<b>Total assets</b>	<b>139</b>
<b>Liabilities assumed:</b>	
Current liabilities:	
Accounts payable	(4)
<b>Purchase price</b>	<b>135</b>

On 1 October 2013, the Lorillard Business acquired certain assets and operations of *SKYCIG*<sup>®</sup>, a United Kingdom-based electronic cigarette (e-cigarette) business for approximately £28 million (approximately \$46 million at 1 October 2013 exchange rates) in cash paid at closing and contingent consideration of up to an additional £30 million (approximately \$49 million at 1 October 2013 exchange rates) to be paid in 2016 based on the achievement of certain financial performance benchmarks. This gave rise to goodwill of \$38 million which is attributable to acquired customer base and economies of scale expected from combining the operations of the Lorillard Business.

The results of operations of *SKYCIG* are included in our consolidated Lorillard HFI beginning as of 1 October 2013. The Lorillard Business' consolidated revenues include \$4 million of sales of *SKYCIG* during the year ended 2013. *SKYCIG* had an operating loss of US\$7 million since the date of acquisition. The Lorillard Business incurred \$4 million of acquisition-related expenses during 2013, recorded in administrative and other expenses in the Income Statement.

The Lorillard Business is still in the process of finalizing a working capital adjustment that may increase total consideration transferred by up to \$2 million. Therefore, the purchase price and goodwill amounts noted below could increase by up to US\$2 million as a result of finalising this working capital adjustment. The fair values of the assets acquired and liabilities assumed at the date of acquisition are summarised below (in millions):

<b>Assets acquired:</b>	<b>\$ million</b>
Current assets:	
Accounts receivable	1
<b>Total current assets</b>	<b>1</b>
Goodwill	38
Intangible assets	36
<b>Total assets</b>	<b>75</b>
<b>Liabilities assumed:</b>	
Current liabilities:	
Accounts payable	(3)
Accrued liabilities	(1)
<b>Total current liabilities</b>	<b>(4)</b>
Earn out liability	(25)
<b>Purchase price</b>	<b>46</b>

The fair value of the *SKYCIG* earn out liability (the **Earn Out**), classified as Level 3, was determined utilizing a discounted cash flows approach using various probability-weighted *SKYCIG* 2015 financial performance scenarios, upon which the ultimate earn out liability to be paid in 2016 will be based. Significant unobservable inputs used in calculating the fair value of the Earn Out include various *SKYCIG* financial performance scenarios, the probability of achieving those scenarios, and the discount rate. Based upon this calculation, the fair value of the Earn Out was determined to be £15 million (approximately \$25 million) as of the date of the acquisition (1 October 2013) and 31 December 2013. The amount of the Earn Out that will be ultimately paid in 2016 could range from £0 to £30 million (approximately \$0 to \$49 million at 31 December 2013 exchange rates).

## 19 Related parties

Key management compensation is presented in note 6.

Included in administrative and other expenses in the accompanying combined income statement are fees paid to related parties of members of the Board of Directors of Lorillard of \$2 million (2012: \$2 million; 2011: \$2 million).

### **Lorillard Investment in the Lorillard Business**

It is not meaningful to show share capital or retained earnings for the Business. The net assets are represented by the net investment of Lorillard, which comprises share capital and retained earnings of the Lorillard Business after eliminating investments and transactions between the Lorillard Business, Lorillard or its subsidiaries.

All significant intercompany transactions between Lorillard and the Lorillard Business have been included in these combined Lorillard HFI and are considered to be effectively settled for cash at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the combined statements of changes in equity.

## 20 Financial Risk Management

In the normal course of commercial activity the Lorillard Business is exposed to certain financial risks, as outlined below:

The Lorillard Business has minimal exposure to liquidity risk arising from insufficient funds to meet its financing needs because it has no cash or debt as Lorillard uses a centralised approach to cash management and financing its operations.

The Lorillard Business has minimal exposure to most market risks as it has no debt and its sales transactions are all denominated in U.S. dollars and therefore is not exposed to movements in foreign exchange rates. Refer to note 16 for market risk associated with the Lorillard Business' pension assets.

There is exposure to commodity price risk in that there may be fluctuations in the price of tobacco leaf. In the production of cigarettes, Lorillard uses domestic and foreign grown burley and flue-cured leaf tobaccos, as well as aromatic tobaccos grown primarily in Turkey and other Near Eastern countries. Lorillard believes that there is an adequate supply of leaf tobacco of the type and quality they require at competitive prices from a combination of global sources, and that Lorillard is not dependent on any one geographic region or country for its requirements. Lorillard purchases its leaf tobacco through tobacco dealers, which contract with leaf growers. Such purchases are made at prevailing market prices in the country of origin. Due to the varying size and quality of annual crops, changes in the value of the U.S. dollar in relation to other foreign currencies and other economic factors, tobacco prices have historically fluctuated. Lorillard directs these dealers in the purchase of tobacco according to its specifications for quality, grade, yield, particle size, moisture content, and other characteristics. The dealers purchase and process the whole leaf and then dry and package it for shipment to and storage at Lorillard's Danville, Virginia facility. Lorillard has not experienced any difficulty in purchasing its requirement of leaf tobacco. Lorillard purchased approximately 86%, 90% and 88% of its leaf tobacco through a limited number of suppliers in 2013, 2012 and 2011. If these suppliers become unwilling or unable to supply leaf tobacco to Lorillard, it believes that it can readily obtain high quality leaf tobacco from well-established, alternative industry sources. However, Lorillard believes that such high quality leaf tobacco may not be available at prices comparable to those it currently pays.

The Business is exposed to credit risk arising from its trade receivables due from customers, but has implemented policies to ensure that sales of products are made to customers with an appropriate credit history and in 2013, approximately 99% of cigarette customers purchased cigarettes using electronic funds transfer, which provides immediate payment to us.

The Business' objectives when managing capital are to safeguard the Business' ability to continue as a going concern in order to provide returns for Lorillard and benefits for other stakeholders and to maintain an optimal capital structure. The Business manages its capital through a centralised approach with Lorillard.

## 21 Subsequent events

On 15 July 2014, Reynolds, Lorillard and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds, entered into the Merger Agreement. Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will own 100 per cent. of the outstanding capital stock of Lorillard.

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, and Reynolds entered into the Asset Purchase Agreement, pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands certain assets of Reynolds and its relevant affiliates used primarily in, or arising directly or indirectly out of the operation or conduct of, the businesses of the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*. Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent.

## SECTION F

### UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL INFORMATION RELATING TO THE LORILLARD BUSINESS TO 30 SEPTEMBER 2014

#### Unaudited Combined Income Statement

\$ million	Notes	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
<b>Revenue</b>		<b>5,876</b>	<b>5,938</b>	<b>7,900</b>
Duty and similar items		(2,671)	(2,687)	(3,581)
Other cost of sales		(469)	(497)	(656)
<b>Cost of sales</b>		<b>(3,140)</b>	<b>(3,184)</b>	<b>(4,237)</b>
<b>Gross profit</b>		<b>2,736</b>	<b>2,754</b>	<b>3,663</b>
Distribution, advertising and selling costs		(845)	(912)	(1,194)
Acquisition costs		—	(4)	(4)
Amortisation of acquired intangibles		(22)	(4)	(12)
Other expenses		(207)	(176)	(298)
<b>Administrative and other expenses</b>		<b>(229)</b>	<b>(184)</b>	<b>(314)</b>
<b>Operating profit / profit before taxation</b>		<b>1,662</b>	<b>1,658</b>	<b>2,155</b>
Taxation	5	(639)	(628)	(817)
<b>Profit for the period</b>		<b>1,023</b>	<b>1,030</b>	<b>1,338</b>

Profit for the periods presented is entirely attributable to the owners of the Lorillard Business (as defined in Note 1).

The condensed combined interim financial information may not be representative of future results, for example, the historical capital structure does not reflect the future capital structure and future interest income and expense, pension costs and certain other operating costs and tax charges may be significantly different from those that resulted from being wholly owned by Lorillard.

The notes on pages 108 to 115 are an integral part of the condensed combined interim financial information.

## Unaudited Combined Statement of Comprehensive Income

\$ million	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
<b>Profit for the period</b>	<b>1,023</b>	<b>1,030</b>	<b>1,338</b>
<b>Other comprehensive income:</b>			
Exchange movements	—	—	1
<b>Items that may be reclassified to profit and loss</b>	<b>—</b>	<b>—</b>	<b>1</b>
Net actuarial gains on retirement benefits	4	12	77
Deferred tax relating to net gains on retirement benefits	(2)	(5)	(32)
<b>Items that will not be reclassified to profit and loss</b>	<b>2</b>	<b>7</b>	<b>45</b>
<b>Total comprehensive income for the period</b>	<b>1,025</b>	<b>1,037</b>	<b>1,384</b>

The notes on pages 108 to 115 are an integral part of the condensed combined interim financial information.

## Reconciliation from operating profit to adjusted EBITDA

\$ million	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
Operating profit / Profit before taxation	1,662	1,658	2,155
Depreciation	37	33	43
Amortisation	22	4	13
<b>EBITDA</b>	<b>1,721</b>	<b>1,695</b>	<b>2,211</b>
Volume Adjustment Offset	63	43	57
<b>Adjusted EBITDA</b>	<b>1,784</b>	<b>1,738</b>	<b>2,268</b>

A non-recurring volume adjustment offset of approximately US\$63 million relating to the Initial State Settlements was incurred by the Lorillard Business in the nine months ended 30 September 2014 (2013: US\$43 million). The volume adjustment offset is dependent on total profitability of the U.S. tobacco industry and is reviewed and calculated on an annual basis should certain thresholds be met.

## Reconciliation from Revenue to Net revenue

\$ million	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
Revenue	5,876	5,938	7,900
Duty and similar items	(2,671)	(2,687)	(3,581)
<b>Net Revenue</b>	<b>3,205</b>	<b>3,251</b>	<b>4,319</b>



## Reconciliation from Gross profit to Brand contribution

<b>\$ million</b>	<b>9 months ended 30 September 2014</b>	<b>9 months ended 30 September 2013</b>	<b>Year ended 31 December 2013</b>
Gross profit	2,736	2,754	3,663
Advertising and support	(726)	(793)	(1,034)
<b>Brand contribution</b>	<b>2,010</b>	<b>1,961</b>	<b>2,629</b>

## Unaudited Combined Balance Sheet

<b>\$ million</b>	<b>30 September 2014</b>	<b>30 September 2013</b>	<b>31 December 2013</b>
<b>Non-current assets</b>			
Intangible assets	166	114	192
Property, plant and equipment	302	311	303
Deferred tax assets	452	465	504
Retirement benefit assets	69	8	55
Other	2	6	3
	<b>991</b>	<b>904</b>	<b>1,057</b>
<b>Current assets</b>			
Inventories	737	729	764
Trade and other receivables	72	101	72
	<b>809</b>	<b>830</b>	<b>836</b>
<b>Total assets</b>	<b>1,800</b>	<b>1,734</b>	<b>1,893</b>
<b>Current liabilities</b>			
Trade and other payables	(1,336)	(1,346)	(1,524)
	<b>(1,336)</b>	<b>(1,346)</b>	<b>(1,524)</b>
<b>Non-current liabilities</b>			
Retirement benefit obligations	(116)	(106)	(108)
Provisions	(22)	(2)	(27)
	<b>(138)</b>	<b>(108)</b>	<b>(135)</b>
<b>Total liabilities</b>	<b>(1,474)</b>	<b>(1,454)</b>	<b>(1,659)</b>
<b>Net assets</b>	<b>326</b>	<b>280</b>	<b>234</b>
<b>Invested capital attributable to owners of the Lorillard Business</b>			
Invested capital	326	280	234
<b>Total invested capital</b>	<b>326</b>	<b>280</b>	<b>234</b>

The notes on pages 108 to 115 are an integral part of the condensed combined interim financial information.

# **Unaudited Combined Statement of Changes in Invested Capital**

<b>\$ million</b>	<b>Invested capital</b>
<b>At 1 January 2014</b>	<b>234</b>
Profit for the period	1,023
Other comprehensive income	2
<b>Total comprehensive income</b>	<b>1,025</b>
<b>Transactions with owners</b>	
Share based compensation	16
Excess tax benefit on share-based compensation	8
Transactions with owners of the Lorillard Business	(957)
<b>At 30 September 2014</b>	<b>326</b>
<b>At 1 January 2013</b>	<b>21</b>
Profit for the period	1,030
Other comprehensive income	7
<b>Total comprehensive income</b>	<b>1,037</b>
<b>Transactions with owners</b>	
Share based compensation	16
Excess tax benefit on share-based compensation	7
Transactions with owners of the Lorillard Business	(801)
<b>At 30 September 2013</b>	<b>280</b>

The notes on pages 108 to 115 are an integral part of the condensed combined interim financial information.

## Unaudited Combined Cash Flow Statement

\$ million	9 months ended 30 September 2014	9 months ended 30 September 2013	Year ended 31 December 2013
<b>Cash flows from operating activities</b>			
Operating profit	1,662	1,658	2,155
Depreciation, amortisation and impairment	59	37	56
Post-retirement benefits	(2)	(1)	18
Costs of employees' services compensated by share schemes	16	16	18
<b>Operating cash flows before movement in working capital</b>	<b>1,735</b>	<b>1,710</b>	<b>2,247</b>
Increase/(decrease) in inventories	27	(74)	(109)
Decrease in trade and other receivables	—	(43)	(14)
(Decrease)/Increase in trade and other payables	(188)	(157)	17
(Decrease)/increase in other	6	14	26
<b>Movement in working capital</b>	<b>(155)</b>	<b>(260)</b>	<b>(80)</b>
<b>Taxation paid</b>	<b>(589)</b>	<b>(601)</b>	<b>(856)</b>
<b>Net cash flows generated by operating activities</b>	<b>991</b>	<b>849</b>	<b>1,311</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	(34)	(48)	(50)
Purchase of intangible assets	—	—	(12)
Purchases of businesses – net of cash acquired	—	—	(46)
<b>Net cash used in investing activities</b>	<b>(34)</b>	<b>(48)</b>	<b>(108)</b>
<b>Cash flows from financing activities</b>			
Transactions with owners of the Lorillard Business	(957)	(801)	(1,203)
<b>Net cash (used in) financing activities</b>	<b>(957)</b>	<b>(801)</b>	<b>(1,203)</b>
<b>Net increase in cash and cash equivalents</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at start of period</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Cash and cash equivalents at end of period</b>	<b>—</b>	<b>—</b>	<b>—</b>

The notes on pages 108 to 115 are an integral part of the condensed combined interim financial information.

Lorillard and its subsidiaries from time to time and, where context requires, each one of them (the **Lorillard Group**) uses a centralised approach to cash management and financing its operations. Transactions between Lorillard and the carve-out group are accounted for through invested capital. Accordingly, none of the cash, cash equivalents, debt or related interest expense at the corporate level has been assigned to the carve-out in this interim financial information.

## NOTES TO THE CONDENSED COMBINED INTERIM FINANCIAL INFORMATION

### 1 Background to the transaction and nature of the business

#### Background to the transaction

On 15 July 2014, Reynolds, Lorillard, Inc. (**Lorillard**) and Lantern Acquisition Co., a wholly owned subsidiary of Reynolds American Inc. (**Reynolds**), entered into an agreement and plan of merger (the **Merger Agreement**). Pursuant to, and subject to the terms of, the Merger Agreement, Lantern Acquisition Co. will merge with and into Lorillard. As a result of the merger, the separate corporate existence of Lantern Acquisition Co. will cease, and Lorillard will be the surviving corporation in the merger such that Reynolds will own 100 per cent of the outstanding capital stock of Lorillard (the **Merger**).

Concurrently with the execution of the Merger Agreement, Imperial, ITG Brands, LLC (formerly called Lignum-2 LLC) (a wholly-owned subsidiary of Imperial) (**ITG Brands**), and Reynolds entered into an agreement (the **Asset Purchase Agreement**), pursuant to which Reynolds has agreed, following consummation of the Merger, to sell to ITG Brands (and/or any one or more of Imperial's subsidiaries from time to time (the **Imperial Group**)) the cigarette brands known as *Winston*, *Kool*, *Salem* and *Maverick* and the e-cigarette brand *blu*, and the associated assets, employees, offices, production facilities and certain associated liabilities of Reynolds and Lorillard and their relevant affiliates (the **Acquired Assets**) (the **Acquisition**). Reynolds has also agreed, pursuant to the terms of the Asset Purchase Agreement, to transfer to ITG Brands the cigarette brand known as *Doral* for no additional consideration in the event that the aggregate market share in the U.S. of *Winston*, *Kool* and *Salem* for the three months prior to completion of the Acquisition is less than 4.9 per cent. (*Winston*, *Kool* and *Salem*, together with *Maverick* and, if applicable, the *Doral* brand being the **Acquired Tobacco Cigarette Brands**)

#### Nature of the business

The *Maverick* and *blu* brands, and the associated assets, properties, licences, rights, employees and certain associated liabilities which form part of the Acquired Assets and are being acquired by ITG Brands or a member of the Imperial Group as part of the Acquisition and that are owned by, or relate to, the Lorillard Group as at the date of this document are hereafter referred to as the **Lorillard Business**.

The accompanying historical interim information (the **Lorillard Interim Financial Information**) reflects the assets, liabilities, revenues and expenses attributed to the Lorillard Business which includes the revenue earned and expenses incurred by Lorillard on those brands produced by it which are not being acquired by Imperial but which will be manufactured for Reynolds under the Reciprocal Manufacturing Agreement.

Note 4 to this interim financial information discloses the split of revenue and gross profit attributable to the acquired and non-acquired brands of the Lorillard Business.

The interim financial information on the Acquired Assets owned as at the date of this document by Reynolds is set out in Section C of Part 5 of this document.

### 2 Accounting Policies

#### Basis of Preparation

The interim condensed combined financial information comprises the unaudited results for the nine months ended 30 September 2014 and 30 September 2013, together with the audited results for the year ended 31 December 2013.

This condensed combined set of interim financial information for the nine months ended 30 September 2014 has been prepared in accordance with IAS 34, 'Interim Financial Reporting', as adopted by the European Union. The condensed set of interim financial information for the nine months ended 30 September 2014 should be read in conjunction with the Lorillard Business historical financial information (**Lorillard HFI**) for the year ended 31 December 2013 which has been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Lorillard Business' principal accounting policies used in preparing this information are as stated in the Lorillard HFI for the year ended 31 December 2013, as set out in Section E of Part 5 of this document. This interim condensed combined financial information has been prepared in accordance with IFRS consistent with that applied by Imperial in its 30 September 2014 financial statements.

#### New Accounting Standards and Interpretations

New standards or interpretations which came into effect for the current reporting period did not have a material impact on the net assets or results of the Lorillard Business.

Other standards and interpretations issued, but not yet effective, are not expected to have a material effect on the Lorillard Business' net assets or results.

### 3 Critical Accounting Estimates and Judgments

The Lorillard Business makes estimates and judgments regarding the future. Estimates and judgments are continually evaluated based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In the future, actual experience may deviate from these estimates and judgments. The estimates and judgments that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the current financial year are discussed in the Lorillard HFI for the year ended 31 December 2013.

### 4 Segment Information

9 months ended 30 September 2014			
\$ million	Cigarettes	e-Cigarettes	Total
Revenue	5,732	144	5,876
Profit before taxation	1,710	(48)	1,662
– Acquisition expenses	—	—	—
– Amortisation of acquired brand	—	22	22
<b>Adjusted profit before taxation</b>	<b>1,710</b>	<b>(26)</b>	<b>1,684</b>
9 months ended 30 September 2013			
\$ million	Cigarettes	e-Cigarettes	Total
Revenue	5,752	186	5,938
Profit before taxation	1,650	8	1,658
– Acquisition expenses	4	—	4
– Amortisation of acquired brand	—	4	4
<b>Adjusted profit before taxation</b>	<b>1,654</b>	<b>12</b>	<b>1,666</b>
Year ended 31 December 2013			
\$ million	Cigarettes	e-Cigarettes	Total
Revenue	7,656	244	7,900
Profit before taxation	2,161	(6)	2,155
– Acquisition expenses	4	—	4
– Amortisation of acquired brand	—	12	12
<b>Adjusted profit before taxation</b>	<b>2,165</b>	<b>6</b>	<b>2,171</b>

9 months ended 30 September 2014				
\$ million	Cigarettes	e-Cigarettes	Consolidation Adjustments	Total
Depreciation and amortisation	37	22	—	59
Additions to PPE	32	2	—	34
Total assets	1,673	252	(125)	1,800

9 months ended 30 September 2013				
\$ million	Cigarettes	e-Cigarettes	Consolidation Adjustments	Total
Depreciation and amortisation	33	4	—	37
Additions to PPE	47	1	—	48
Total assets	1,651	208	(125)	1,734

Year ended 31 December 2013				
\$ million	Cigarettes	e-Cigarettes	Consolidation Adjustments	Total
Depreciation and amortisation	44	12	—	56
Additions to PPE	49	1	—	50
Total assets	1,727	291	(125)	1,893

The results of the Lorillard Business for each period are presented below split between the results of the brands to be acquired by Imperial as part of the Acquisition and non-acquired brands manufactured but excluded from Imperial's Acquisition.

9 months ended 30 September 2014			
\$ million	Acquired brands	Non-acquired brands	Total
<b>Revenue</b>	<b>644</b>	<b>5,232</b>	<b>5,876</b>
Duty and similar items	(344)	(2,327)	(2,671)
Other cost of sales	(131)	(338)	(469)
Cost of sales	(475)	(2,665)	(3,140)
Gross profit	169	2,567	2,736
Distribution, advertising and selling costs			(845)
Acquisition costs			—
Amortisation of acquired intangibles			(22)
Other expenses			(207)
<b>Administrative and other expenses</b>			<b>(229)</b>
Operating profit / Profit before taxation			1,662
Taxation			(639)
<b>Profit for the year</b>			<b>1,023</b>

9 months ended 30 September 2013

\$ million	Acquired brands	Non-acquired brands	Total
<b>Revenue</b>	<b>689</b>	<b>5,249</b>	<b>5,938</b>
Duty and similar items	(356)	(2,331)	(2,687)
Other cost of sales	(169)	(328)	(497)
Cost of sales	(525)	(2,659)	(3,184)
Gross profit	164	2,590	2,754
Distribution, advertising and selling costs			(912)
Acquisition costs			(4)
Amortisation of acquired intangibles			(4)
Other expenses			(176)
<b>Administrative and other expenses</b>			<b>(184)</b>
Operating profit / Profit before taxation			1,658
Taxation			(628)
<b>Profit for the year</b>			<b>1,030</b>

Year ended 31 December 2013

\$ million	Acquired brands	Non-acquired brands	Total
<b>Revenue</b>	<b>912</b>	<b>6,988</b>	<b>7,900</b>
Duty and similar items	(493)	(3,088)	(3,581)
Other cost of sales	(218)	(438)	(656)
Cost of sales	(711)	(3,526)	(4,237)
Gross profit	201	3,462	3,663
Distribution, advertising and selling costs			(1,194)
Acquisition costs			(4)
Amortisation of acquired intangibles			(12)
Other expenses			(298)
<b>Administrative and other expenses</b>			<b>(314)</b>
Operating profit / Profit before taxation			2,155
Taxation			(817)
<b>Profit for the year</b>			<b>1,338</b>



## 5 Taxation

### Analysis of charge in the periods

Reported tax for the nine months ended 30 September 2014 and 2013 has been calculated on the basis of an estimated effective tax rate for the years ended 31 December 2014 and 2013. The estimated annual tax rate for the year ended 31 December 2014 is 38.1% (the estimated tax rate for the nine months ended 30 September 2013 was 37.3%).

## 6 Intangible Assets

On 1 October 2013, Lorillard completed the acquisition of certain assets and operations of SKYCIG, now trading as blu (U.K.). The fair value ascribed to the SKYCIG trademark and trade name in connection with the acquisition is being amortised over an estimated life of 18 months, beginning 1 October 2013, after which amortisation charges related to the trademark and trade name will cease.

## 7 Retirement Benefit Schemes

The Lorillard Business has defined benefit and defined contribution pensions, postretirement benefits to active participants, profit sharing and savings plans for eligible employees.

In addition Lorillard has a defined benefit pension plan 'The Salaried Pension Plan' as well as other post-retirement benefits to non-active participants. These schemes are not included in the Acquisition and accordingly excluded from the balance sheet of this carve out combined historical financial information. The full charge for all schemes, acquired and non-acquired, are reflected in the Income Statement.

The Hourly Pension Plan provides benefits based on fixed amounts for each year of service. The Lorillard Business also provides medical and life insurance benefits to eligible employees who are active members at the time of Acquisition, there are two schemes the 'Salaried and Hourly post-employment medical plans'. The Lorillard Business uses a December 31 measurement date for its plans.

The results of the most recent actuarial valuations have been updated to 31 December 2013 by independent qualified actuaries in order to determine the amounts to be included in the condensed combined financial information.

The Lorillard Business also provides certain senior level management employees with nonqualified, unfunded supplemental retirement plans. While these plans are unfunded, the Lorillard Business has certain assets invested in an executive life insurance policy that are to be used to provide for certain of these benefits.

## 8 Legal Proceedings and Disputes

Lorillard has historically recognised provisions for *tobacco-related legal claims* in its consolidated financial statements for litigations made against its group companies. These legal claims are not directly attributable to specific brands and relate to periods prior to those presented in the interim financial information. Additionally, the *Maverick* brand is to be acquired without historic product liabilities. An indemnity against such liabilities has also been provided by Reynolds in the Asset Purchase Agreement to take effect from completion of the Acquisition. Therefore, as there is no rational basis for allocating legal costs to the Lorillard Business, provisions for *tobacco-related legal claims* and the associated external legal costs have not been allocated or attributed to the Lorillard Business and are excluded from the interim financial information.

The Lorillard Business reviews other outstanding legal cases following developments in the legal proceedings at each balance sheet date, considering the nature of the litigation, claim or assessment, the legal processes and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought; the progress of the case (including progress after the date of the interim financial information but before those statements are issued); the opinions or views of legal counsel and other advisers; experience of similar cases; and any decision of the Lorillard Business' management as to how it will respond to the litigation, claim or assessment.

To the extent that the Lorillard Business' assessments at any time do not reflect subsequent developments or the eventual outcome of any claim, its future financial statements may be materially affected, with a favourable or adverse impact upon the Lorillard Business' operating profit, financial position and liquidity.

#### **Settlement of State Reimbursement Litigation**

On November 23, 1998, Lorillard Tobacco, Philip Morris Incorporated, Brown & Williamson Tobacco Corporation and R.J. Reynolds Tobacco Company (the **Original Participating Manufacturers** or **OPMs**”) entered into the Master Settlement Agreement (the **MSA**) with 46 States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands to settle the asserted and unasserted health care cost recovery and certain other claims of those States. These settling entities are general referred to as the “**Settling States**”. The Original Participating Manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota, which together with the MSA are referred to as the “State Settlement Agreements”.

The State Settlement Agreements provide that the agreements are not admissions, concessions or evidence of any liability or wrongdoing on the part of any party, and were entered into by the Original Participating Manufacturers to avoid the further expense, inconvenience, burden and uncertainty of litigation. The Lorillard Business recorded pretax charges for its obligations under the State Settlement Agreements of \$888 million and \$1.016 billion for the nine months ended September 30, 2013 and 2014, respectively. The Lorillard Business' portion of ongoing adjusted settlement payments and legal fees is based on its share of domestic cigarette shipments in the year preceding that in which the payment is due. Accordingly, the Lorillard Business records its portions of ongoing adjusted settlement payments as part of cost of manufactured products sold as the related sales occur.

The State Settlement Agreements require that the OPMs make annual payments of \$10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs' attorneys' fees, subject to an annual cap of \$500 million, and were required to pay an additional amount of up to \$125 million in each year through 2008. These payment obligations are the several and not joint obligations of each OPM. The State Settlement Agreements also include provisions relating to significant advertising and marketing restrictions, public disclosure of certain industry documents (now lapsed), limitations on challenges to tobacco control and underage use laws, and other provisions.

From time to time, lawsuits have been brought against Lorillard Tobacco and other participating manufacturers to the MSA, or against one or more of the Settling States, challenging the validity of the MSA on certain grounds, including as a violation of the antitrust laws.

In addition, in connection with the MSA, the Original Participating Manufacturers entered into an agreement to establish a US\$5.2 billion trust fund payable between 1999 and 2010 to compensate the tobacco growing communities in 14 states (the **Trust**). Payments to the Trust ended in 2005 as a result of an assessment imposed under a federal law, enacted in 2004, repealing the federal supply management program for tobacco growers. Under the law, tobacco quota holders and growers will be compensated over 10 years with payments totaling \$10.1 billion, funded by an assessment on tobacco manufacturers and importers. Payments under the law to qualifying tobacco quota holders and growers commenced in 2005 and completed in 2014. The Lorillard Business recorded pretax charges for its obligations under the law of \$92 million and \$92 million for the nine months ended September 30, 2013 and 2014, respectively.

The Lorillard Business believes that the State Settlement Agreements will materially adversely affect its cash flows and operating income in future years. The degree of the adverse impact will depend, among other things, on the rates of decline in domestic cigarette sales in the premium price and discount price segments, the Lorillard Business' share of the domestic premium price and discount price cigarette segments, and the effect of any resulting cost advantage of manufacturers not subject to significant payment obligations under the State Settlement Agreements.

### Electronic Cigarette Matters

On 7 April 2014, LOEC filed a complaint for declaratory judgment of trademark non-infringement against Zippmark, Inc. (**Zippmark**) and Zippo Manufacturing Company (**ZMC**) (together **Zippo**) in the United States District Court for the Central District of California. The lawsuit was predicated by Zippmark's decision to file oppositions with the United States Patent and Trademark Office's Trademark Trial and Appeal Board against Lorillard Technologies, Inc.'s (**LTI**) applications to register certain trademarks for BLU and allegations that Lorillard infringed several of Zippo's registered trademarks. On May 19, 2014, Zippo filed an answer and counterclaim for trademark infringement. Zippo's counterclaim is for, amongst other things, injunctive relief, treble damages and an accounting of profits (unspecified sums), attorneys fees and costs. On 12 June 2014, LOEC filed its answer to Zippo's counterclaim and filed its own counterclaim seeking to cancel certain Zippo trademarks based on descriptiveness and for false/fraudulent registration. On 7 July 2014, Zippo responded to LOEC's counterclaim and included a counterclaim in reply seeking to cancel LTI's registered trademark for BLU ECIGS. On 28 July 2014, LOEC filed an answer to Zippmark's counterclaim in reply for cancellation of LTI's registered trademark. On 11 August 2014, LTI filed its answer to Zippmark's counterclaim in reply for cancellation of its registered trademark. According to the minutes of a scheduling conference dated 21 July 2014, the cut-off date for discovery is set for 22 January 2015. The trial date is scheduled for 21 April 2015.

On 14 and 18 July 2014, ZMC filed three applications with the UK Intellectual Property Office (**UK IPO**) to declare invalid three International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK in class 34 and owned by LTI. On 29 August 2014, Cygnet UK Trading Ltd (**Cygnet**), a subsidiary of Lorillard, and LTI filed a claim against ZMC for: (a) groundless threats of infringement proceedings; and (b) declarations of non-infringement with respect to ZMC's Community Trade Mark numbers 004629689 and 005232211, and any other ZMC trade mark which incorporates the word "BLU" or any word or logo immaterially different to it. Lorillard issued a press release on 3 September 2014 in relation to this claim entitled "Lorillard Subsidiaries Sue Zippo in the UK to Stop Unfounded Threats Against BLU ECIGS". On 6 October 2014, LTI filed its notices of defence and counterstatement with the UK IPO with respect to its International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK. On 22 October 2014, ZMC entered a defence to Cygnet and LTI's claim denying that it had made a groundless threat, and served a counterclaim alleging Cygnet's and LTI's use of the various *blu* marks infringed ZMC's Community Trade Marks. ZMC's counterclaim is for, amongst other things, injunctive relief, damages or an accounting of profits, and costs. On 19 November 2014, Cygnet and LTI filed its defence denying infringement of the Community Trade Marks and served a counterclaim to revoke those Community Trade Marks for non-use and/or invalidate the Community Trade Marks due to the fact that they are devoid of distinctive character, descriptive of the products in relation to which they are registered and, or in the alternative, are deceptive in relation to certain of the products in relation to which they are registered. On 10 December 2014, ZMC filed its defence to Cygnet and LTI's counterclaim, denying that its Community Trade Marks are or were at any material time invalid.

On 15 April 2014, ZMC filed oppositions against CTM Application Nos. 12592572 *blu* eCIGS (stylised) and 12580651 BLU owned by LTI. ZMC has based its oppositions on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device.

On 22 June 2014, ZMC filed cancellation actions in Austria in relation to LTI's International Registrations numbers WO0000001051365, WO0000001058275 and WO0000001051607. No proceedings have been served on LTI.

On 22 August 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140613A BLU owned by LTI. On 28 November 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140614A *blu* eCIGS (stylised) owned by LTI. ZMC has based its opposition on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device.

On 6 August 2014, ZMC obtained a preliminary injunction from the District Court of Frankfurt am Main against Cygnet UK Trading Ltd., on the basis of ZMC's Community Trademarks for BLU. The injunction was served on Cygnet UK Trading Ltd. on 26 November 2014. Cygnet UK Trading Ltd. is complying with the injunction and has ceased selling BLU e-cigarettes and related products in Germany.

On 7 May 2014 (issued on 25 August 2014), ZMC filed at the Trademark Appeal Board of the State Administration for Industry and Commerce of the People's Republic of China three applications for the invalidation of LTI's *blu* eCIGS (stylised) trademark with International Registration number 1058275, BLU ECIGS trademark with International Registration number 1051365 and BLU CIGS trademark with International Registration number 1051607 registered in class 34. With respect to International Registration No. 1051365 BLU ECIGS, ZMC has argued that LTI disclaimed of the word "ECIGS" and as a result the distinctive part of the mark must be constrained to "BLU". On 30 September 2014, LTI filed its defence to the three invalidity actions against International Registration Nos. 1058275, 1051365 & 1051607. On 14 November 2014, LTI filed non-use cancellation proceedings against ZMC's registration Nos. 4912199 and 6131784 in Class 34 and 6131785 and 6131786 in Class 4 for BLU & Device.

Zippo has opposed LTI's Canadian Trade-mark Application No. 1501523 for the mark BLU ECIGS & Design on the basis of prior rights and likelihood of confusion. Zippo cross-examined LTI's President and LOEC's Vice President of Marketing on 12 November 2014 and the transcript is required to be filed by 23 January 2015.

### **Defenses**

Each of Lorillard Tobacco and Lorillard, Inc. believes that it has defenses to the above cases pending against it as well as bases for appeal should any adverse verdicts be returned against either of them.

### **Other Litigation**

LOEC, Inc. is also a defendant in four lawsuits filed on 22 June 2012, 5 March 2014, 21 October 2014, and 2 December 2014 by Ruyan Investment (Holdings) Limited and its successor companies, Fontem Ventures and Fontem Holdings 1 B.V., both companies being owned and controlled by the Imperial Group in the United States District Court for the Central District of California, alleging infringement of certain patents owned by Fontem Holdings 1 B.V. and exclusively licensed to Fontem Ventures related to electronic cigarette technology. The first case filed 22 June 2012 has been stayed pending proceedings before the United States Patent and Trademark Office. The second case filed 5 March 2014 is currently stayed. The third and fourth cases filed 21 October 2014 and 2 December 2014 have not yet been served on LOEC. No provision for this action has been made in these financial statements due to the current status of the claim (stayed) and the fact that the counter-party is a subsidiary of the Imperial Group.

Lorillard is also party to other litigation arising in the ordinary course of business. The outcome of this other litigation will not, in the opinion of management, materially affect Lorillard's results of operations or invested capital.

## **9 Related Parties**

Key management compensation amounted to \$17 million for the nine months ended 30 September 2014 (nine months ended 30 September 2013: \$18 million; year ended 31 December 2013: \$24 million).

Included in administrative and other expenses in the accompanying combined income statement are fees paid to related parties of members of the Board of Directors of Lorillard of \$2 million (nine months ended 30 September 2013: \$1 million; year ended 31 December 2013: \$2 million).

### **Lorillard Investment in the Lorillard Business**

It is not meaningful to show share capital or retained earnings for the Lorillard Business. The net assets are represented by the net investment of Lorillard, which comprises share capital and retained earnings of the Lorillard Business after eliminating investments and transactions between the Lorillard Business, Lorillard or its subsidiaries.

All significant intercompany transactions between Lorillard and the Lorillard Business have been included in the Lorillard interim financial information and are considered to be effectively settled for cash at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the combined statements of changes in invested capital.

## SECTION G

### UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

#### 1. Pro forma financial information

The unaudited *pro forma* statement of net assets of the Enlarged Group is based on the net assets of the Imperial Group as at 30 September 2014 and has been prepared on the basis of the notes accompanying it to illustrate the effect of the Acquisition on the net assets of the Imperial Group as if it had been completed on that date.

The unaudited *pro forma* income statement of the Enlarged Group is based on the income statement of the Imperial Group for the year ended 30 September 2014 and has been prepared on the basis of the notes accompanying it to illustrate the effect of the Acquisition on the income statement of the Imperial Group as if it had been completed on 1 October 2013.

The financial information in respect of the Reynolds Business and the Lorillard Business for the 12 months to 30 September 2014 has been prepared by combining the unaudited combined income statements for the nine months ended 30 September 2014 with the audited year ended 31 December 2013 and eliminating the unaudited nine months ended 30 September 2013.

The information, which has been produced for illustrative purposes only, by its nature addresses a hypothetical situation and, therefore, does not represent the Imperial Group's actual financial position or results.

Shareholders should read the whole of this document and not rely solely on the summarised financial information contained in this Section G of Part 5.

## 2. Unaudited *pro forma* statement of net assets of the Enlarged Group

	Adjustments			
	Imperial Group as at 30 September 2014 £m	Acquired Assets as at 30 September 2014 £m	Acquisition Accounting £m	<i>Pro Forma</i> Enlarged Group as at 30 September 2014 £m
	(Note 1)	(Note 2)	(Note 5)	
<b>Non-current assets</b>				
Intangible assets	15,859	103	3,994	19,956
Property, plant and equipment	1,862	128	—	1,990
Investments in associates	17	—	—	17
Retirement benefit assets	44	43	—	87
Trade and other receivables	75	—	—	75
Derivative financial instruments	605	—	—	605
Deferred tax assets	241	11	—	252
	<b>18,703</b>	<b>285</b>	<b>3,994</b>	<b>22,982</b>
<b>Current assets</b>				
Inventories	2,935	166	—	3,101
Trade and other receivables	2,806	—	—	2,806
Current tax assets	96	—	—	96
Cash and cash equivalents	1,431	—	—	1,431
Derivative financial instruments	38	—	—	38
	<b>7,306</b>	<b>166</b>	<b>—</b>	<b>7,472</b>
<b>Total assets</b>	<b>26,009</b>	<b>451</b>	<b>3,994</b>	<b>30,454</b>
<b>Current liabilities</b>				
Borrowings	(468)	—	—	(468)
Derivative financial instruments	(46)	—	—	(46)
Trade and other payables	(6,990)	—	—	(6,990)
Current tax liabilities	(133)	—	—	(133)
Provisions	(176)	—	—	(176)
	<b>(7,813)</b>	<b>—</b>	<b>—</b>	<b>(7,813)</b>
<b>Non-current liabilities</b>				
Borrowings	(9,464)	—	(4,379)	(13,843)
Derivative financial instruments	(645)	—	—	(645)
Trade and other payables	(21)	—	—	(21)
Deferred tax liabilities	(1,453)	—	—	(1,453)
Retirement benefit liabilities	(824)	(72)	—	(896)
Provisions	(312)	(14)	—	(326)
	<b>(12,719)</b>	<b>(86)</b>	<b>(4,379)</b>	<b>(17,184)</b>
<b>Total liabilities</b>	<b>(20,532)</b>	<b>(86)</b>	<b>(4,379)</b>	<b>(24,997)</b>
<b>Net assets</b>	<b>5,477</b>	<b>365</b>	<b>(385)</b>	<b>5,457</b>



### 3. Unaudited *pro forma* Income Statement of the Enlarged Group

	Adjustments			
	Imperial Group for the year ended 30 September 2014 £m	Acquired Assets for the 12 months ended 30 September 2014 £m	Acquisition Accounting £m	<i>Pro Forma</i> Enlarged Group for the year ended 30 September 2014 £m
	(Note 1)	(Note 2)	(Note 5)	
<b>Revenue</b>	26,625	2,342	—	28,967
Duty and similar items	(12,928)	(1,081)	—	(14,009)
Other cost of sales	(8,422)	(375)	—	(8,797)
<b>Cost of sales</b>	<b>(21,350)</b>	<b>(1,456)</b>	<b>—</b>	<b>(22,806)</b>
<b>Gross profit</b>	<b>5,275</b>	<b>886</b>	<b>—</b>	<b>6,161</b>
Distribution, advertising and selling costs	(1,946)	(298)	—	(2,244)
Acquisition costs	(13)	—	(20)	(33)
Amortisation of acquired intangibles	(644)	(19)	—	(663)
Restructuring costs	(305)	—	—	(305)
Other expenses	(303)	(210)	—	(513)
<b>Administrative and other expenses</b>	<b>(1,265)</b>	<b>(229)</b>	<b>(20)</b>	<b>(1,514)</b>
<b>Operating profit</b>	<b>2,064</b>	<b>359</b>	<b>(20)</b>	<b>2,403</b>
Investment income	517	—	—	517
Finance costs	(1,061)	—	(103)	(1,164)
<b>Net finance costs</b>	<b>(544)</b>	<b>—</b>	<b>(103)</b>	<b>(647)</b>
<b>Profit before taxation</b>	<b>1,520</b>	<b>359</b>	<b>(123)</b>	<b>1,756</b>
Taxation	(69)	(132)	27	(174)
<b>Profit for the year</b>	<b>1,451</b>	<b>227</b>	<b>(96)</b>	<b>1,582</b>



**Note 1. Financial Information for the Imperial Group**

The financial information for the Imperial Group has been extracted, without material adjustment, from the audited consolidated financial statements of the Imperial Group for the year ended 30 September 2014.

**Note 2. Reconciliation to the Acquired Assets as at and for the 12 months ended 30 September 2014**

The unaudited statement of net assets of the Acquired Assets, as set out below, is calculated using the adjusted Reynolds and Lorillard net asset statements as set out in Notes 3 and 4 respectively.

	As adjusted Reynolds Business as at 30 September 2014 \$m	As adjusted Lorillard Business as at 30 September 2014 \$m	Acquired Assets as at 30 September 2014 \$m	Acquired Assets as at 30 September 2014 £m
	Note 3	Note 4		
<b>Non-current assets</b>				
Intangible assets	—	166	166	103
Property, plant and equipment	11	195	206	128
Retirement benefit assets	—	69	69	43
Deferred tax assets	—	18	18	11
	<b>11</b>	<b>448</b>	<b>459</b>	<b>285</b>
<b>Current assets</b>				
Inventories	118	151	269	166
	<b>118</b>	<b>151</b>	<b>269</b>	<b>166</b>
<b>Total assets</b>	<b>129</b>	<b>599</b>	<b>728</b>	<b>451</b>
<b>Non-current liabilities</b>				
Retirement benefit obligations	—	(116)	(116)	(72)
Provisions	—	(22)	(22)	(14)
	<b>—</b>	<b>(138)</b>	<b>(138)</b>	<b>(86)</b>
<b>Total liabilities</b>	<b>—</b>	<b>(138)</b>	<b>(138)</b>	<b>(86)</b>
<b>Net assets</b>	<b>129</b>	<b>461</b>	<b>590</b>	<b>365</b>

Figures have been translated from US\$ into GBP using an exchange rate of £1:\$1.6188 being the exchange rate prevailing as at 30 September 2014, the date of Imperial Group's 2014 audited financial statements.

The unaudited income statement of the Acquired Assets, set out below, is calculated using the adjusted Reynolds and Lorillard income statements as set in Notes 3 and 4 respectively.

	As adjusted Reynolds Business for the 12 months ended 30 September 2014 \$m	As adjusted Lorillard Business for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 £m
	Note 3	Note 4		
<b>Revenue</b>	<b>2,654</b>	<b>1,138</b>	<b>3,792</b>	<b>2,342</b>
Duty and similar items	(1,269)	(481)	(1,750)	(1,081)
Other cost of sales	(179)	(427)	(606)	(375)
<b>Cost of sales</b>	<b>(1,448)</b>	<b>(908)</b>	<b>(2,356)</b>	<b>(1,456)</b>
<b>Gross profit</b>	<b>1,206</b>	<b>230</b>	<b>1,436</b>	<b>886</b>
Distribution, advertising and selling costs	(262)	(220)	(482)	(298)
Amortisation of acquired intangibles	—	(30)	(30)	(19)
Other expenses	(12)	(329)	(341)	(210)
<b>Administrative and other expenses</b>	<b>(12)</b>	<b>(359)</b>	<b>(371)</b>	<b>(229)</b>
<b>Operating profit / (loss) and Profit / (loss) before taxation</b>	<b>932</b>	<b>(349)</b>	<b>583</b>	<b>359</b>
Taxation	(348)	134	(214)	(132)
<b>Profit / (loss) for the year</b>	<b>584</b>	<b>(215)</b>	<b>369</b>	<b>227</b>

Figures have been translated from US\$ into GBP using an exchange rate of £1:\$1.6188 being the exchange rate prevailing as at 30 September 2014, the date of Imperial Group's 2014 audited financial statements.

**Note 3. Reconciliation to the unaudited Adjusted Reynolds Business as at and for the 12 months ended 30 September 2014**

**Unaudited net assets statement of the Reynolds Business as at 30 September 2014**

The unaudited net assets of the Acquired Assets owned by, or related to, the Reynolds Group at the date of this document (the **Reynolds Business**) as at 30 September 2014 are based on the combined balance sheet of the Reynolds Business as at 30 September 2014 extracted without material adjustment from the unaudited Reynolds Business Historical Financial Information set out in Section B of Part 5 of this document, and adjusted to reflect the terms of the Asset Purchase Agreement and to reflect future arrangements under the Reciprocal Manufacturing Agreement (RMA).

A reconciliation is presented below:

	<b>Reynolds Business as at 30 September 2014 \$m</b>	<b>Adjustments \$m</b>	<b>As Adjusted Reynolds Business as at 30 September 2014 \$m</b>
<b>Non-current assets</b>			
Property, plant and equipment	—	11	11
Deferred tax assets	142	(142)	—
	<b>142</b>	<b>(131)</b>	<b>11</b>
<b>Current assets</b>			
Inventories	118	—	118
Trade and other receivables	42	(42)	—
	<b>160</b>	<b>(42)</b>	<b>118</b>
<b>Total assets</b>	<b>302</b>	<b>(173)</b>	<b>129</b>
<b>Current liabilities</b>			
Trade and other payables	(411)	411	—
	<b>(411)</b>	<b>411</b>	<b>—</b>
<b>Net (liabilities)/ assets</b>	<b>(109)</b>	<b>238</b>	<b>129</b>

The adjustments reflect the accounting for the Acquisition on the following basis:

- As part of the Reciprocal Manufacturing Agreement, certain machinery and equipment owned by Reynolds, but not included in the Reynolds Business Historical Financial Information, will transfer to the Imperial Group. Accordingly, a *pro forma* adjustment has been included to recognise this asset (\$11 million).
- No trade and other receivables or trade and other payables (including Master Settlement Agreement, or **MSA**, accruals) are being acquired by the Imperial Group. They are therefore eliminated as an adjustment to the *pro forma* balance sheet.
- Deferred tax assets relating to **MSA** accruals are also eliminated as an adjustment to the *pro forma* balance sheet, as these do not transfer as part of the Acquisition.

# **Unaudited Reynolds Business Income statement for the 12 months ended 30 September 2014**

The unaudited income statement of the Reynolds Business for the 12 months ended 30 September 2014 is based on the unaudited combined income statement of the Reynolds Business for the nine months ended 30 September 2014, combined with the audited year ended 31 December 2013, after eliminating the unaudited nine months ended 30 September 2013 as follows:

	<b>Reynolds Business for the 9 months ended 30 September 2014 \$m</b>	<b>Reynolds Business for the year ended 31 December 2013 \$m</b>	<b>Reynolds Business for the 9 months ended 30 September 2013 \$m</b>	<b>Reynolds Business for the 12 months ended 30 September 2014 \$m</b>
<b>Revenue</b>	<b>1,974</b>	<b>2,800</b>	<b>(2,120)</b>	<b>2,654</b>
Duty and similar items	(942)	(1,347)	1,020	(1,269)
Other cost of sales	(125)	(183)	140	(168)
<b>Cost of sales</b>	<b>(1,067)</b>	<b>(1,530)</b>	<b>1,160</b>	<b>(1,437)</b>
<b>Gross profit</b>	<b>907</b>	<b>1,270</b>	<b>(960)</b>	<b>1,217</b>
Distribution, advertising and selling costs	(219)	(320)	243	(296)
Amortisation of acquired intangibles	—	(69)	69	—
Other expenses	(74)	(117)	85	(106)
<b>Administrative and other expenses</b>	<b>(74)</b>	<b>(186)</b>	<b>154</b>	<b>(106)</b>
<b>Operating profit / Profit before taxation</b>	<b>614</b>	<b>764</b>	<b>(563)</b>	<b>815</b>
Taxation	(227)	(293)	216	(304)
<b>Profit for the period</b>	<b>387</b>	<b>471</b>	<b>(347)</b>	<b>511</b>

The results to 30 September 2014 and 30 September 2013 are extracted without material adjustment from the unaudited historical financial information set out in Section C of this document and the results to 31 December 2013 are extracted without material adjustment from the audited historical financial information set out in Section B of this document.

The above results have then been adjusted to reflect the terms of the Asset Purchase Agreement to reflect future arrangements under the RMA as follows:

	Reynolds Business for the 12 months ended 30 September 2014 \$m	Adjustments \$m	As adjusted Reynolds Business for the 12 months ended 30 September 2014 \$m
<b>Revenue</b>	<b>2,654</b>	<b>—</b>	<b>2,654</b>
Duty and similar items	(1,269)	—	(1,269)
Other cost of sales	(168)	(11)	(179)
<b>Cost of sales</b>	<b>(1,437)</b>	<b>(11)</b>	<b>(1,448)</b>
<b>Gross profit</b>	<b>1,217</b>	<b>(11)</b>	<b>1,206</b>
Distribution, advertising and selling costs	(296)	34	(262)
Amortisation of acquired intangibles	—	—	—
Other expenses	(106)	94	(12)
<b>Administrative and other expenses</b>	<b>(106)</b>	<b>94</b>	<b>(12)</b>
<b>Operating profit / Profit before taxation</b>	<b>815</b>	<b>117</b>	<b>932</b>
Taxation	(304)	(44)	(348)
<b>Profit for the year</b>	<b>511</b>	<b>73</b>	<b>584</b>

The adjustments reflect the accounting for the Acquisition on the following basis:

- Under the terms of the RMA, for a transitional period, Reynolds will exclusively manufacture and supply Imperial Group's requirements for *Winston*, *Kool* and *Salem* brand products at cost plus 10 per cent. (excluding leaf costs). Accordingly, cost of sales has been adjusted by US\$11m to reflect the additional cost of producing the brands being acquired by the Imperial Group under this arrangement.
- Selling costs of US\$34 million relating to sales staff who, whilst attributable to the brands which are being acquired by the Imperial Group, are not transferring as part of the deal and will not be incurred on a go-forward basis and are eliminated from the *pro forma* income statement.
- Corporate allocations of US\$94 million from Reynolds, whilst attributable to the brands which are being acquired by the Imperial Group, will not be incurred on a go-forward basis and are eliminated from the *pro forma* income statement.
- Taxation on the above adjustments at the Reynolds Business effective rate of tax of 37%.

Post transaction, the services and resultant costs eliminated in adjustments (b) and (c) will be performed by a combination of the Lorillard Business and the Imperial Group's existing U.S. operations.

**Note 4. Reconciliation to the unaudited Adjusted Lorillard Business as at and for the 12 months ended 30 September 2014**

**Unaudited net assets statement of the Lorillard Business as at 30 September 2014**

The net assets of the Acquired Assets owned by, or relate to, the Lorillard Group at the date of this document (the **Lorillard Business**) as at 30 September 2014 are based on the combined balance sheet of the Lorillard Business as at 30 September 2014, extracted without material adjustment from the unaudited historical financial information set out in Section E of Part 5 of this document, and adjusted to reflect the terms of the Asset Purchase Agreement and RMA.

A reconciliation is presented below:

	Lorillard Business as at 30 September 2014 \$m	Adjustments \$m	As adjusted Lorillard Business as at 30 September 2014 \$m
<b>Non-current assets</b>			
Intangible assets	166	—	166
Property, plant and equipment	302	(107)	195
Retirement benefit assets	69	—	69
Deferred tax assets	452	(434)	18
Other	2	(2)	—
	<b>991</b>	<b>(543)</b>	<b>448</b>
<b>Current assets</b>			
Inventories	737	(586)	151
Trade and other receivables	72	(72)	—
	<b>809</b>	<b>(658)</b>	<b>151</b>
<b>Total assets</b>	<b>1,800</b>	<b>(1,201)</b>	<b>599</b>
<b>Current liabilities</b>			
Trade and other payables	(1,336)	1,336	—
	(1,336)	1,336	—
<b>Non-current liabilities</b>			
Retirement benefit obligations	(116)	—	(116)
Provisions	(22)	—	(22)
	<b>(138)</b>	<b>—</b>	<b>(138)</b>
<b>Total liabilities</b>	<b>(1,474)</b>	<b>1,336</b>	<b>(138)</b>
<b>Net assets</b>	<b>326</b>	<b>135</b>	<b>461</b>

The adjustments reflect the accounting for the Acquisition on the following basis:

- a) As part of the Reciprocal Manufacturing Agreement, certain machinery and equipment owned by Lorillard, will transfer to Reynolds. Accordingly, a *pro forma* adjustment has been included to derecognise this asset (\$107 million).
- b) Inventory relating to the brands being retained by Reynolds is not being acquired by the Imperial Group. Leaf inventory to be acquired at the date of completion of the Acquisition will be calculated based on the relative volumes of the *Maverick* brand and the brands being retained by Reynolds at that date. Therefore, US\$586 million of inventory, estimated as the proportion of inventory at 30 September 2014 relating to retained brands, has been eliminated as an adjustment to the *pro forma* balance sheet.
- c) No trade and other receivables, other non-current assets or trade and other payables are being acquired by the Imperial Group. They are therefore eliminated as an adjustment to the *pro forma* balance sheet.

- d) Deferred tax assets of \$434 million, relating to MSA accruals (US\$469 million asset) and other items (\$35 million liability) which do not transfer as part of the Acquisition, are eliminated as an adjustment to the *pro forma* balance sheet. The remaining deferred tax asset relates to pensions (US\$18 million).

**Unaudited Lorillard Business Income statement for the 12 months ended 30 September 2014**

The unaudited income statement of the Lorillard Business for the 12 months ended 30 September 2014 is based on the unaudited combined income statement of the Lorillard Business for the nine months ended 30 September 2014, combined with the audited year ended 31 December 2013, after eliminating the unaudited nine months ended 30 September 2013 and, as follows:

	<b>Lorillard Business for the 9 months ended 30 September 2014 \$m</b>	<b>Lorillard Business for the year ended 31 December 2013 \$m</b>	<b>Lorillard Business for the 9 months ended 30 September 2013 \$m</b>	<b>Lorillard Business for the 12 months ended 30 September 2014 \$m</b>
<b>Revenue</b>	<b>5,876</b>	<b>7,900</b>	<b>(5,938)</b>	<b>7,838</b>
Duty and similar items	(2,671)	(3,581)	2,687	(3,565)
Other cost of sales	(469)	(656)	497	(628)
<b>Cost of sales</b>	<b>(3,140)</b>	<b>(4,237)</b>	<b>3,184</b>	<b>(4,193)</b>
<b>Gross profit</b>	<b>2,736</b>	<b>3,663</b>	<b>(2,754)</b>	<b>3,645</b>
Distribution, advertising and selling costs	(845)	(1,194)	912	(1,127)
Acquisition costs	—	(4)	4	—
Amortisation of acquired intangibles	(22)	(12)	4	(30)
Other expenses	(207)	(298)	176	(329)
<b>Administrative and other expenses</b>	<b>(229)</b>	<b>(314)</b>	<b>184</b>	<b>(359)</b>
<b>Operating profit /</b>				
<b>Profit before taxation</b>	<b>1,662</b>	<b>2,155</b>	<b>(1,658)</b>	<b>2,159</b>
Taxation	(639)	(817)	628	(828)
<b>Profit for the year</b>	<b>1,023</b>	<b>1,338</b>	<b>(1,030)</b>	<b>1,331</b>



The above results have then been adjusted to reflect the terms of the Asset Purchase Agreement to reflect future arrangements under the RMA as follows:

	<b>Lorillard Business for the 12 months to 30 September 2014 \$m</b>	<b>Adjustments \$m</b>	<b>As adjusted Lorillard Business for the 12 months to 30 September 2014 \$m</b>
<b>Revenue</b>	<b>7,838</b>	<b>(6,700)</b>	<b>1,138</b>
Duty and similar items	(3,565)	3,084	(481)
Other cost of sales	(628)	201	(427)
<b>Cost of sales</b>	<b>(4,193)</b>	<b>3,285</b>	<b>(908)</b>
<b>Gross profit</b>	<b>3,645</b>	<b>(3,415)</b>	<b>230</b>
Distribution, advertising and selling costs	(1,127)	907	(220)
Amortisation of acquired intangibles	(30)	—	(30)
Other expenses	(329)	—	(329)
<b>Administrative and other expenses</b>	<b>(359)</b>	<b>—</b>	<b>(359)</b>
<b>Operating profit / (loss) and Profit / (loss) before taxation</b>	<b>2,159</b>	<b>(2,508)</b>	<b>(349)</b>
Taxation	(828)	962	134
<b>Profit / (loss) for the year</b>	<b>1,331</b>	<b>(1,546)</b>	<b>(215)</b>

The adjustments reflect the accounting for the Acquisition on the following basis:

- Under the terms of the RMA, for a transitional period, the Imperial Group will exclusively manufacture and supply Reynolds' requirements for *Newport* brand products at cost plus 10 per cent. (excluding leaf costs). Accordingly, Lorillard revenue of US\$6,700 million, duty of US\$3,084 million and leaf costs of US\$201 million have been adjusted to reflect these agreed terms.
- Certain distribution and advertising costs totalling US\$907 million relating to the Newport brand will not be incurred going forward. Accordingly, these have been eliminated from the *pro forma* income statement.
- Taxation on the above adjustments at the Lantern Business effective rate of tax of 38%.

## Note 5. Acquisition Accounting

The Acquisition Accounting adjustments reflect the accounting for the Acquisition on the following basis:

### Net assets adjustments

- a) The adjustment reflects goodwill and intangible assets arising on the Acquisition and has been accounted for using the acquisition method of accounting. The excess of consideration over the book value acquired has been reflected as goodwill and intangible assets. No account has been taken of any fair value adjustments which may arise upon the Acquisition as any such fair value adjustments cannot be accurately and reliably estimated at this time. The amount of goodwill and other intangible assets has been calculated as follows:

	Note	£m
Cash consideration	(i)	4,359
Less net assets acquired of the as adjusted Reynolds & Lorillard Businesses	(ii)	(365)
<b>Goodwill and intangible assets</b>		<b>3,994</b>

- i) Reflecting total cash consideration of US\$7,056 million payable to Reynolds<sup>10</sup>.
- ii) Reflecting the net assets of £365 million (\$590 million) acquired of the Reynolds Business and Lorillard Business, as presented in note 2 above.
- b) Draw down of a Revolving Credit Facility to settle the cash consideration of £4,359 million (US\$7,056 million) payable to Reynolds, and £20 million in additional transaction fees, totalling £4,379 million.

### Income statement adjustments

- a) Additional transaction fees of £20 million, and a related tax benefit of £4 million.
- b) Additional finance charge of £103m reflecting the cost of the Revolving Credit Facility referred to above, and a related tax benefit of £23million (at enacted UK corporate tax rates for the year of 22%).
- c) No adjustment has been made to reflect the trading results of the Imperial Group, the Reynolds Business or the Lorillard Business, since 30 September 2014.

All of the adjustments described in the above notes to the Unaudited Pro Forma Income Statement will have a continuing impact, with the exception of the adjustment in (a) in relation to transaction costs of £20 million.

<sup>10</sup> Translated from US\$ into GBP using an exchange rate of £1:\$1.6188 being the exchange rate prevailing as at 30 September 2014, the date of Imperial Group's 2014 audited financial statements.

**Note 6: Unaudited adjusted metrics**

The following adjusted metrics are presented to enhance the understanding of the financial information presented for the Acquired Assets:

**Unaudited reconciliation from operating profit to adjusted EBITDA**

	As adjusted Reynolds Business for the 12 months ended 30 September 2014 \$m	As adjusted Lorillard Business for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 £m
Operating profit / (loss) and Profit / (loss) before taxation	932	(349)	583	359
Depreciation	—	47	47	29
Amortisation	—	31	31	20
<b>EBITDA</b>	<b>932</b>	<b>(271)</b>	<b>661</b>	<b>408</b>
Volume adjustment offset	—	77	77	48
<b>Adjusted EBITDA</b>	<b>932</b>	<b>(194)</b>	<b>738</b>	<b>456</b>

A charge of US\$47m in the 12 months to September 2014 relates to the depreciation of fixed assets currently owned by Lorillard that will be transferred to Imperial as part of the Acquisition. Amortisation charges of US\$31m in the 12 months to 30 September 2014 relate to the amortisation of brands and software being acquired from Lorillard.

Adjusted EBITDA reflects a non-recurring volume adjustment offset of US\$77m relating to the Initial State Settlements incurred by Lorillard in the 12 months to 30 September 2014.

**Unaudited adjusted EBITDA for the Pro Forma Enlarged Group can be reconciled as follows:**

	Imperial Group for the year ended 30 September 2014 £m	Acquired Assets for the 12 months ended 30 September 2014 £m	Acquisition Accounting £m	Pro Forma Enlarged Group for the year ended 30 September 2014 £m
<b>£ million</b>				
Operating profit / Profit before taxation	2,064	359	(20)	2,403
Depreciation <sup>11</sup>	252	29	—	281
Amortisation	668	20	—	688
<b>EBITDA</b>	<b>2,984</b>	<b>408</b>	<b>(20)</b>	<b>3,372</b>
Acquisition costs	13	—	20	33
Restructuring costs	305	—	—	305
Volume adjustment offset	—	48	—	48
<b>Adjusted EBITDA</b>	<b>3,302</b>	<b>456</b>	<b>—</b>	<b>3,758</b>

11 Imperial Group depreciation of £252 million includes a £160 million depreciation charge and a £92 million impairment charge on fixed assets, mostly relating to the closure of the Nottingham site.

# Unaudited reconciliation from Revenue to Net revenue

	As adjusted Reynolds Business for the 12 months ended 30 September 2014 \$m	As adjusted Lorillard Business for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 \$m	Acquired assets for the 12 months ended 30 September 2014 £m
Revenue	2,654	1,138	3,792	2,342
Duty and similar items	(1,269)	(481)	(1,750)	(1,081)
<b>Net Revenue</b>	<b>1,385</b>	<b>657</b>	<b>2,042</b>	<b>1,261</b>

Unaudited Net Revenue (excluding logistics revenue) for the Pro Forma Enlarged Group can be reconciled as follows:

£ million	Imperial Group for the year ended 30 September 2014 £m	Acquired Assets for the 12 months ended 30 September 2014 £m	<i>Pro Forma</i> Enlarged Group for the year ended 30 September 2014 £m
Revenue (excluding logistics revenue)	19,656	2,342	21,998
Duty and similar items	(13,080)	(1,081)	(14,161)
<b>Net Revenue (excluding logistics revenue)</b>	<b>6,576</b>	<b>1,261</b>	<b>7,837</b>

# Unaudited reconciliation from Gross profit to Brand contribution

	As adjusted Reynolds Business for the 12 months ended 30 September 2014 \$m	As adjusted Lorillard Business for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 \$m	Acquired Assets for the 12 months ended 30 September 2014 £m
Gross profit	1,206	230	1,436	886
Advertising and support	(227)	(80)	(307)	(190)
<b>Brand contribution</b>	<b>979</b>	<b>150</b>	<b>1,129</b>	<b>696</b>

#### 4. Accountant's report on the unaudited pro forma financial information



The Directors  
Imperial Tobacco Group PLC  
121 Winterstoke Road  
Bristol  
BS3 2LL

Credit Suisse Securities (Europe) Limited  
One Cabot Square  
London  
E14 4QJ

15 December 2014

Dear Sirs

##### **Imperial Tobacco Group PLC (the Company)**

We report on the unaudited *pro forma* financial information (the **Pro forma financial information**) set out in Section G of Part 5 of the Company's circular dated 15 December 2014 (the **Circular**) which has been prepared on the basis described in the notes to the Pro forma financial information, for illustrative purposes only, to provide information about how the proposed acquisition of certain U.S. cigarette and e-cigarette Brands and assets currently owned by Reynolds American Inc. and Lorillard, Inc. might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ending 30 September 2014. This report is required by item 13.3.3R of the Listing Rules of the U.K. Listing Authority (the **Listing Rules**) and is given for the purpose of complying with that Listing Rule and for no other purpose.

##### **Responsibilities**

It is the responsibility of the directors of the Company to prepare the Pro forma financial information in accordance with item 13.3.3R of the Listing Rules.

It is our responsibility to form an opinion, as required by item 13.3.3R of the Listing Rules as to the proper compilation of the Pro forma financial information and to report our opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with item 13.4.1R(6) of the Listing Rules, consenting to its inclusion in the Circular.

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*PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH*

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.

**Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing standards or other standards and practices generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

**Opinion**

In our opinion:

- a) the Pro forma financial information has been properly compiled on the basis stated; and
- b) such basis is consistent with the accounting policies of the Company.

Yours faithfully

PricewaterhouseCoopers LLP  
Chartered Accountants

## PART 6

### ADDITIONAL INFORMATION

#### 1. Responsibility

Imperial and the Directors, whose names appear in paragraph 4 of this Part 6, accept responsibility for the information contained in this document. To the best of the knowledge and belief of Imperial and the Directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

#### 2. Incorporation and registered office

- 2.1 Imperial was incorporated and registered in England and Wales on 6 August 1996 with company number 03236483 as a public limited company under the Companies Act 1985 for an unlimited duration.
- 2.2 Imperial is domiciled in England and Wales and its registered and head office is at 121 Winterstoke Road, Bristol BS3 2LL, England (telephone number: +44 (0) 117 963 6636). Imperial was listed on 1 October 1996, when the tobacco business of Hanson PLC (Hanson) was transferred to Imperial in consideration for the issue of £52 million of shares in Imperial to Hanson shareholders. The ordinary shares of Imperial were admitted to the Official List of the London Stock Exchange on 1 October 1996.
- 2.3 The principal legislation under which Imperial operates is the Companies Act and regulations made thereunder.

#### 3. Share capital

The issued and fully paid share capital of Imperial as at the Effective Date is as follows:

Issued and fully paid Imperial Shares	Number	Amount (£)
Ordinary Shares	1,036,000,000	103,600,000.00 <sup>(1)</sup>

**Notes:**

- (1) As at 12 December 2014, 78,909,137 Ordinary Shares are held as treasury shares (representing 7.62 per cent. of the total ordinary share capital in issue).

#### 4. Directors

The Directors of Imperial and their positions as at the date of this document are as follows:

Name of Director	Position
Mark Williamson	Chairman
Alison Cooper	Chief Executive
Oliver Tant	Chief Financial Officer
Matthew Phillips	Corporate Affairs Director
Ken Burnett	Non-Executive Director
David Haines	Non-Executive Director
Michael Herlihy	Senior Independent Non-Executive Director
Karen Witts	Non-Executive Director
Malcolm Wyman	Non-Executive Director

#### 5. Directors' and Senior Managers' interests in Imperial

- 5.1 The aggregate interests of each of the Directors, senior managers and their immediate families in the share capital of the Company (all of which are beneficial unless otherwise stated), which:
- (a) have been notified to the Company pursuant to 3.1.2R and 3.1.3R of the Disclosure and Transparency Rules; or
- (b) are interests of a connected person (within the meaning of the Disclosure and Transparency Rules) which would, if the connected person were a Director, be required to be disclosed under paragraph 5.1(a) above and the existence of which is known to, or could with reasonable diligence be ascertained by, that Director,



were, as at the Effective Date, and are expected to be, immediately following completion of the Acquisition, as follows:

Name of Director / senior manager	Number of Ordinary Shares owned outright <sup>(1)</sup>	Percentage of issued ordinary share capital <sup>(1)</sup>
Mark Williamson	8,241	0.0009
Alison Cooper	162,111 <sup>(2)</sup>	0.0169
Oliver Tant	829 <sup>(3)</sup>	0.00009
Matthew Phillips	43,765 <sup>(4)</sup>	0.0046
Ken Burnett	2,591	0.00027
David Haines	647	0.00007
Michael Herlihy	4,624	0.00048
Karen Witts	131	0.00001
Malcolm Wyman	3,559	0.00037

**Notes:**

- (1) Excluding Ordinary Shares held in treasury.  
(2) It is expected that Alison Cooper will acquire approximately £185,000 worth of additional shares on or about 17 December 2014.  
(3) It is expected that Oliver Tant will acquire approximately £10,000 worth of additional shares on or about 17 December 2014.  
(4) It is expected that Matthew Phillips will acquire approximately £3,000 worth of additional shares on or about 17 December 2014.

- 5.2 The interests of the Directors and senior managers together represent approximately 0.0237 per cent. of the issued share capital of Imperial (excluding treasury shares) as at the Effective Date.

### 5.3 Imperial share plans, options and awards

(a) *The Imperial Tobacco Group Share Matching Scheme (the SMS)*

As at close of business on the Effective Date, the contingent rights to Ordinary Shares under the SMS for the Directors and senior managers in the SMS was as follows:

Name of Director / senior manager	Number of unvested Ordinary Shares subject to award and performance conditions	Date of vesting
Alison Cooper	21,415	15 February 2015 <sup>(1)</sup>
	37,197	15 February 2016
	40,000	15 February 2017
Matthew Phillips	10,473	15 February 2015 <sup>(1)</sup>
	10,914	15 February 2016
	16,076	15 February 2017

**Notes:**

- (1) The performance conditions in respect of this award were not met. As a result it will lapse in full on 15 February 2015

Employees who lodge shares that they own or acquire (up to the value of their gross SMS eligible annual bonus) under the SMS are granted an award over a number of additional shares in a ratio not exceeding one additional share for every lodged share. Provided the participant remains an employee of the Group (or has left as a good leaver) at the end of the three year vesting period, and to the extent that the applicable performance conditions have been satisfied, they will receive a number of the additional shares (together with any dividends accrued on them during the performance period) and be free to deal with their lodged shares. Participants have no rights to the additional shares during the vesting period and the award will lapse to the extent the lodged shares are not retained in the SMS. There is no opportunity to retest the performance conditions and the awards are

subject to claw-back provisions. Subject to Shareholder approval of the revised remuneration policy, no further awards will be granted to executive directors under the SMS.

(b) *The Imperial Tobacco Group Long Term Incentive Plan (the LTIP)*

As at close of business on the Effective Date, the following options over Ordinary Shares of Imperial have been granted to Directors and senior managers under certain of the LTIP:

<b>Name of Director / senior manager</b>	<b>Number of Ordinary Shares over which Option granted subject to performance conditions</b>	<b>Exercise price per Option (pence)</b>	<b>Exercise period</b>
Alison Cooper	73,688	GBP 0.01	3 December 2015 <sup>(1)</sup> – 3 December 2022
	77,246	GBP 0.01	6 November 2016 <sup>(1)</sup> – 6 November 2023
Oliver Tant	36,209	GBP 0.01	6 November 2016 <sup>(1)</sup> – 6 November 2023
Matthew Phillips	21,776	GBP 0.01	3 December 2015 <sup>(1)</sup> – 3 December 2022
	22,827	GBP 0.01	6 November 2016 <sup>(1)</sup> – 6 November 2023

**Notes:**

(1) Subject to Imperial having announced by that date its Full Year results to 30 September preceding.

An employee who is selected to participate in the LTIP is granted a conditional award over a number of shares that have a value at grant equal to a percentage of the employee's salary. Provided the participant remains an employee of the Group (or has left as a Good Leaver) at the end of the three year vesting period, and to the extent that the applicable performance conditions have been satisfied, they will receive an option to acquire a number of the shares subject to the award (together with any dividends accrued on them during the performance period). Participants have no rights to the shares subject to their award during the vesting period and the award. There is no opportunity to retest the performance conditions and the awards are subject to malus and claw-back provisions. Executive directors will be required to retain shares acquired under the LTIP for a period of two years after vesting.

(c) *The Imperial Tobacco Group International Sharesave Plan (the **Sharesave**)*

As at close of business on the Effective Date, the following options over Ordinary Shares of Imperial have been granted to Directors and senior managers under the Sharesave:

<b>Name of Director / senior manager</b>	<b>Number of Ordinary Shares under option</b>	<b>Exercise price per Ordinary Share under option (pence)</b>	<b>Exercise period</b>
Alison Cooper	440	GBP 2,045	1 August 2015 – 31 January 2016
Oliver Tant	441	GBP 2,040	1 August 2017 – 31 January 2018
Matthew Phillips	264	GBP 2,045	1 August 2015 – 31 January 2016
	195	GBP 1,840	1 August 2016 – 31 January 2017

All eligible employees must be invited to participate in the Sharesave. Employees who participate in the Sharesave save a specified amount each month (between £5 and £250) under a savings contract entered into with a savings carrier selected by the Company over a three (or, in the UK only, three or five) year period. At the start of the savings period they are granted an option to purchase the number of ordinary shares that can be purchased with their accumulated savings at a price that represents a discount of up to 20 per cent. of the closing mid-market price of an ordinary share on the day before an invitation to participate in the Sharesave is made. Options can normally be exercised for a period of six months following completion of the savings contract. No performance conditions apply to options granted under the Sharesave.

(d) *Ordinary Shares subject to a holding period*

As at close of business on the Effective Date, the following Ordinary Shares of Imperial are subject to a holding period:

<b>Name of Director / senior manager</b>	<b>Number of Ordinary Shares subject to holding period</b>	<b>Release Date</b>
Alison Cooper	403	1 October 2015

## 6. Significant interests in shares

- 6.1 As at the Effective Date, in so far as it has been notified to Imperial by virtue of the notifications pursuant to the Companies Act and/or Chapter 5 of the Disclosure and Transparency Rules, the name of each person, other than a Director who, directly or indirectly, is interested in 3 per cent. or more of the voting rights in Imperial and the amount of such person's interest, is as follows:

Shareholder	Number of Imperial Ordinary Shares (millions)	Percentage of existing ordinary shares in issue as at the date Imperial had been notified pursuant to the Companies Act and/or the Disclosure and Transparency Rules
BlackRock Inc.	53 <sup>(2)</sup>	5.51
Invesco Limited	47 <sup>(1)</sup>	4.94
Morgan Stanley Investment Management Limited	42 <sup>(1)</sup>	4.44
Franklin Resources Inc	41 <sup>(2)</sup>	4.30
Capital Group Companies Inc.	38 <sup>(2)</sup>	3.99

**Notes:**

- (1) Direct holding  
(2) Indirect holding

- 6.2 Save as disclosed in this paragraph 6, Imperial is not aware of any interest (within the meaning of the Disclosure and Transparency Rules) which will represent 3 per cent. or more of the voting rights in Imperial following completion.

## 7. Related party transactions

Save as disclosed in the financial information relating to related party transactions as set out:

- (a) in note IX in the notes to the consolidated financial statements for the year ended 30 September 2014 on page 119 of Imperial's 2014 Annual Report and Accounts;
- (b) in note X in the notes to the consolidated financial statements for the year ended 30 September 2013 on page 136 of Imperial's 2013 Annual Report and Accounts;
- (c) in note IX in the notes to the consolidated financial statements for the year ended 30 September 2012 on page 140 of Imperial's 2012 Annual Report and Accounts,

each of which are incorporated by reference into this document, and below, for each of the years ended 30 September 2014, 2013 and 2012, and during the period between 30 September 2014 and the Effective Date, the Imperial Group entered into no transactions with related parties.

Please refer to paragraph 15 of this Part 6 of this document for further details about information incorporated by reference into this document.

## 8. Directors' service contracts and benefits upon termination of employment

### 8.1 Executive Directors

Imperial has entered into service contracts with each of the Executive Directors, the particulars of which as at the Effective Date are:

Name	Appointment date/Date of service agreement if different	Basic annual salary <sup>(1)</sup>	Notice period
Alison Cooper	1 July 2007	£965,000	12 months' notice
Oliver Tant	1 October 2013	£630,000	12 months' notice
Matthew Phillips	31 May 2012	£455,000	12 months' notice

**Note:**

(1) With effect from 1 October 2014.

The Executive Directors' service contracts can be terminated immediately by the Company for cause, which is defined in the contract. The Executive Directors' service agreements contain provisions for payment in lieu of notice in respect of base salary, pension contributions, and 5 per cent. of base salary in respect of other benefits but these are at the Company's sole discretion.

### 8.2 Non-Executive Directors

The Chairman and Non-Executive Directors do not have service agreements but the terms of their appointment, including the time commitment expected, are recorded in letters of appointment which are available for viewing at Imperial's registered office during normal business hours and both prior to and at the annual general meeting of Imperial. In line with Imperial's annual review policy, the Chairman's and Non-Executive Directors' terms of appointment were reviewed and confirmed by the Board on 4 February 2014. Under the terms of Imperial's articles of association, all Directors are subject to annual re-election by shareholders. There are no provisions regarding notice periods in their letters of appointment which state that the Chairman and Non-Executive Directors will only receive payment until the date their appointment ends and, therefore, no compensation is payable on termination.

Non-Executive Director	Date of original appointment	Date of expiry of current appointment period <sup>(1)</sup>
Mark Williamson	1 July 2007	—
Ken Burnett	19 April 2006	—
David Haines	2 February 2012	—
Michael Herlihy	1 July 2007	—
Karen Witts	6 February 2014	—
Malcolm Wyman	3 October 2011	—

**Note:**

(1) This date is reviewed on an annual basis prior to the annual general meeting of Imperial.

Set out below are the annual fees payable as from 1 October 2014:

Chairman	£450,000
Non-Executive Director	£75,000
Senior Independent Director	£25,000
Audit Committee chairmanship	£25,000
Remuneration Committee chairmanship	£25,000

## 9. Material contracts

### 9.1 Imperial Group

The following is a summary of each contract (not being a contract entered into in the ordinary course of business) to which Imperial or any other member of the Imperial Group is or has been a party:

- (a) within the two years immediately preceding the date of this document which is, or may be, material; or

- (b) at any time, which contains provisions under which any member of the Imperial Group has any obligation or entitlement which is material to the Imperial Group as at the date of this document:

(i) *Asset Purchase Agreement*

A description of the principal terms of the Asset Purchase Agreement is set out in paragraph 2 of Part 4 of this document.

(ii) *Euro Medium Term Note Programme*

The euro medium term note programme has been used as a platform for several debt issuances since it was established in 1999. The size of the programme has been increased since its inception, most recently to €15 billion in 2009. The programme was renewed in February 2014 and Imperial expects to make further debt issuances under the programme (which will be updated as necessary) in the future.

(iii) *144A U.S. dollar bond issuances*

Imperial Tobacco Finance PLC, with Imperial and Imperial Tobacco Limited acting as guarantors, in February 2013 issued bonds to qualified institutional buyers in the U.S. and outside of the U.S. under the provisions of Rule 144A and Regulation S, respectively, of the U.S. Securities Act of 1933, as amended. The bonds issued in such manner were US\$1,250,000,000 2.05 per cent. notes maturing in 2018, and US\$1,000,000,000 3.50 per cent. notes maturing in 2023.

(iv) *European Commercial Paper programme*

The euro commercial paper programme was originally established in 2010 and the programme limit was raised most recently to €2.5 billion in May 2014.

(v) *Facilities Agreement*

On 15 July 2014 Imperial Tobacco Finance PLC and Imperial Tobacco Enterprise Finance Limited (as borrowers) and Imperial and Imperial Tobacco Limited (as guarantors) entered into the Facilities Agreement with BNP Paribas Fortis SA/NV, The Royal Bank of Scotland plc, Santander UK plc and Banco Santander, S.A., London Branch as original lenders, whereby committed bank facilities of £7.8 billion (equivalent)<sup>12</sup> comprising term loan and revolving credit facilities are made available to the borrowers. The aggregate principal amount of the term facilities is US\$7.1 billion, through which Imperial proposes to finance the Acquisition. The term loan facilities under the Facilities Agreement are split into three tranches and have a final maturity date of one year (subject to an extension option to extend the final maturity date to two years at Imperial's option), three years and five years respectively after the estimated date of completion of the Acquisition (or after the anniversary of the signing of the Facilities Agreement if sooner). The revolving credit facilities under the Facilities Agreement may be applied towards refinancing certain of Imperial's existing bank facilities and indebtedness under debt capital markets issuances, to provide working capital facilities for the Enlarged Group and to finance payment of fees and expenses related to the Acquisition. The revolving credit facilities under the Facilities Agreement are split into two tranches and have a respective final maturity date of three years (following the exercise of three six month extension periods by Imperial at its option) and five years (extendable beyond this period for a maximum of two years at the lenders' option) after the date of the Facilities Agreement. Primary syndication of the Facilities Agreement was completed on 29 August 2014 with the syndicate now comprising 17 lenders.

The Facilities Agreement contains certain warranties, undertakings and indemnities from Imperial and other Imperial Group companies which are a party to the Facilities Agreement in favour of the lenders that are customary for such an agreement.

<sup>12</sup> Converted at exchange rates of US\$1.70:£1 and €1.25:£1, being the exchange rates used in the announcement made on 15 July 2014.

(vi) *Deeds of Counter Indemnities*

Imperial Tobacco Limited, Imperial Tobacco Finance PLC and Imperial have entered into deeds of counter indemnities (each a **Counter Indemnity**) each dated 3 June 2014 in favour of certain surety companies in consideration for the issue of guarantees by such surety companies in favour of Imperial Tobacco Pension Trustees Limited (or its successor(s) in title) as trustee of the Imperial Tobacco Pension Fund constituted by the definitive trust deed and rules dated 1 March 1995 (as amended from time to time) (the **Pension Fund**) to guarantee the obligations of Imperial Tobacco Limited and other participating companies (or any of their successors) in respect of the Pension Fund for a total amount of up to £400 million. The expiration date of each guarantee is 3 December 2019.

Each Counter Indemnity contains certain warranties, undertakings and indemnities in respect of the business and financial position of the Imperial Group similar to those contained in the Facilities Agreement.

(vii) *Sponsor's Agreement*

Imperial entered into a Sponsor's agreement with Credit Suisse dated the date of this document which sets out the terms and conditions on which it has appointed Credit Suisse as its sponsor for the purpose of the publication of this document. The Sponsor's agreement contains, amongst other things, customary warranties given by Imperial to Credit Suisse and customary indemnities from Imperial in favour of Credit Suisse.

(viii) *Underwriting Agreement*

On 10 July 2014, Imperial and certain of its subsidiaries entered into an underwriting agreement with Credit Suisse, Goldman Sachs, Morgan Stanley & Co. International plc, Banco Bilbao Vizcaya Argentaria, S.A. and Société Générale (the **Underwriters**) in connection with the initial public offering of certain existing shares of Compañía de Distribución Integral Logista Holdings, S.A.U (**Logista Holdings**). Pursuant to the agreement, the Underwriters agreed to procure purchasers for or, failing which, to purchase the shares being sold in the initial public offering. In addition, the Underwriters were granted an over-allotment option to purchase additional shares of Logista Holdings to cover short positions resulting from over-allotments and to facilitate stabilisation transactions during the stabilisation period. Under the agreement, Imperial and such subsidiaries have also agreed to give certain customary representations, warranties and indemnities to the Underwriters in connection with the initial public offering. The initial public offering has been completed, the over-allotment option was exercised in full and the stabilisation period for the initial public offering has now ended.

## 9.2 *The Acquisition*

As referred to in Part 6 of this document, other than for certain limited exceptions, the Acquired Assets do not include any existing contractual arrangements, although the acquisition of the Acquired Assets will also require the Imperial Group to assume additional obligations under the MSA and other State settlements as set out in Part 3 of this document.

The following is a summary of each material contract which forms part of, or relates to the acquisition of, the Acquired Assets:

(i) *Asset Purchase Agreement*

A description of the principal terms of the Asset Purchase Agreement is set out in paragraph 2 of Part 4 of this document.

(ii) *blu acquisition agreement and escrow arrangements*

On 24 April 2012, Lorillard, through its wholly owned subsidiary, Lorillard Holdings Company, Inc. and its subsidiaries, acquired the *blu* eCigs brand and other assets used in the manufacture, distribution, development, research, marketing, advertising, sale and service of electronic cigarettes for US\$135 million, which included a sum of US\$10 million placed in an escrow account (to satisfy indemnity claims made pursuant to the asset



purchase agreement), and the assumption of certain liabilities. The acquisition was made pursuant to an asset purchase agreement with BLEC, LLC, Intermark Brands, LLC and QSN Technologies, LLC.

(iii) *SKYCIG acquisition agreement*

On 1 October 2013, Lorillard entered into an asset purchase agreement to acquire all of the assets and operations of SKYCIG, a United Kingdom-based e-cigarette business for an initial cash consideration of approximately £30 million (approximately US\$49 million at 1 October 2013 exchange rates) in cash (subject to certain adjustments) paid at closing and contingent consideration of up to an additional £30 million (approximately US\$49 million at 1 October 2013 exchange rates) to be paid in 2016 based on the achievement of certain financial performance benchmarks.

## **10. Legal and arbitration proceedings**

### **10.1 Imperial Group**

Except as set out below, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which Imperial is aware) during a period covering the previous 12 months preceding the date of this document which may have, or have had in the recent past, a significant effect on Imperial's and/or the Imperial Group's financial position or profitability:

(a) *Smoking and health-related litigation*

(i) *Litigation in the U.S.*

A subsidiary of the Imperial Group, Commonwealth Brands, is named as a defendant along with numerous other tobacco manufacturers in a 2005 personal injury lawsuit known as *Croft v Akron Gasket, et al*, which was filed in a state court in Cuyahoga County, Ohio.

The claim is in respect of alleged injuries caused by smoking a brand of cigarettes between 1941 and 1943 which were acquired by Commonwealth Brands from another cigarette manufacturer in 1996. A motion for summary judgment was filed by Commonwealth Brands in October 2005. In February 2012, the case was administratively dismissed without prejudice, in an order designated as "final", on a motion filed by Eaton Corporation. Counsel in Ohio has indicated that the plaintiff could attempt to revive or re-file the action under Ohio law.

The potential liability at this stage is considered as zero as the claim has been dormant for several years and, as noted above, has been dismissed. Although there is a possibility the plaintiff could attempt to revive or re-file the action there has been no attempt to revive it for over two years.

(ii) *MSA Matters*

In respect of state health care costs, Commonwealth Brands, SEITA, ITG Brands, Imperial Tobacco Limited and several other Imperial affiliates are signatories to the MSA in the U.S.

The MSA includes an adjustment mechanism, known as a non-participating manufacturer (NPM) adjustment that potentially reduces participating tobacco manufacturers' annual MSA payment obligations. In order for an NPM adjustment to be made, an independent auditor must determine that the participating manufacturers have experienced a market share loss to those manufacturers who are not participants, and an independent firm of economic consultants must determine that the MSA was a significant factor contributing to that loss. The adjustment is then allocated among the settling States that are MSA parties according to whether they "diligently enforced" statutes known as "Qualifying Statutes". Although, for each year from 2003 to 2012 inclusive the two requirements for application of the adjustment have been fulfilled, the relevant settling States dispute that any adjustment is required on the basis that they "diligently enforced" "Qualifying Statutes". This dispute is continuing. The States and manufacturers recently completed arbitration over the 2003 NPM adjustment, with disputes over the remaining years still to be arbitrated.

Effective from 17 December 2012, the manufacturers entered a “term sheet” with 17 States, the District of Columbia, and Puerto Rico setting out terms for settlement of the NPM adjustment for 2003 through to 2012 and addressing the NPM adjustment mechanism for those States for future years. The arbitration panel ordered implementation of certain terms of the settlement and rejected objections to it in March 2013. In April and May 2013 three additional States joined the settlement and two more have joined as of June 2014. This is an ongoing claim by a number of manufacturers and any estimates of credits on settled claims are subject to change depending upon a number of factors included in the calculation of the credits. Certain States that are not parties to the proposed settlement objected to approval of the term sheet by the arbitration panel, and have subsequently filed motions to vacate the settlement in their state courts. The trial-level courts in three settling States have rejected those States’ motions to vacate. Two of those States have filed appeals which are pending. The other state has not appealed so the order denying the motion to vacate the settlement in that state is now final.

The arbitration panel for the 2003 NPM adjustment issued its decisions with respect to the States and territories that did not agree to settle in September 2013. Previously, the manufacturers had advised the panel that they were not contesting diligent enforcement for 16 States. The panel’s decisions found that six of the remaining 15 States that were contested, and that did not settle, were not diligent. As a result, after the panel’s decisions, the manufacturers were set to recover the entire amount remaining for the 2003 NPM adjustment after the *pro rata* reduction ordered by the panel to reflect the settlement and a 20 per cent reduction for a prior settlement.

All of the six States that were found “non-diligent” filed motions to vacate their individual awards in their individual State courts. They sought to overturn the awards entirely, eliminating their liability for the 2003 NPM adjustment, and also sought to reduce their exposure by altering the arbitration panel’s treatment of the settlement. Two of those six States subsequently joined the term sheet settlement resolving the manufacturers’ claims to the 2003 through 2012 adjustment and addressing the NPM adjustment mechanism for those States for future years. In two of the remaining four States, the trial-level state courts have issued decisions denying the States’ requests to overturn the awards entirely but reducing the amount of recovery by changing the panel’s treatment of the settlement. In a third State the trial-level state court has issued a decision denying both the State request to overturn the award entirely and the State request to reduce the amount of recovery. All three of these decisions are on appeal.

(iii) *Litigation in Italy*

Compañía de Distribución Integral Logista S.A.U. (**Logista**), as a distributor of cigarettes, is currently a defendant in a claim commenced before a First Instance Judge (**Giudice di Pace**) in Naples by Mr Eduardo Arnese. The amount of the claim has not been precisely quantified by the claimant and is for damages suffered as a consequence of alleged addiction. Logista filed a challenge to the competence of the Giudice di Pace which was heard in 2006. The judgment on this and other procedural issues is awaited.

At this stage in the proceedings, the value of this claim is unquantifiable.

(b) *Litigation by the Ukrainian government*

In August 2012, Imperial Tobacco Ukraine (**ITU**) received a decision from the State Tax Service Department (the **Department**) seeking to apply financial sanctions equivalent to approximately £87 million based on ITU’s alleged contravention of the law on state regulation of production and circulation of alcohol and tobacco, by engaging in the wholesale trade of tobacco without the correct licence.

ITU’s appeal against the decision was upheld by the Circuit Administrative Court in Kiev in October 2012. The Department’s appeal to the Kiev Administrative Court of Appeal was dismissed in February 2013 and its further appeal to the Superior Administrative Court of Ukraine was dismissed in June 2013. In August 2013, the Superior Administrative Court of Ukraine dismissed the Department’s application for its decision to be reviewed by

the Supreme Court of Ukraine. There are limited circumstances in which the Department could file a further appeal and ITU has been advised that the prospect of this happening is low. As a consequence, the Imperial Group did not provide for any amount in the audited consolidated annual financial statements of Imperial for the financial year ended 30 September 2014 in respect of this matter.

(c) ***European Commission proceedings***

In December 2007, the European Commission (the EC) commenced state aid proceedings against the Spanish state pursuant to Article 88.2 of the European Union Treaty (current Art. 108.2 Treaty on the Functioning of the European Union. 2012/C 326/01), relating to a Spanish tax law which allows the difference between the acquisition value and the net value of a stake in non-Spanish resident entities to be tax deductible in certain circumstances. The EC claimed that the law is selective in favour of certain entities and could have an adverse effect upon competition.

In October 2009, the EC rendered a negative decision with respect to the effect of the Spanish tax law on intra-European Union acquisitions, determining that these tax deductions qualified as state aid, since it provided selective advantage to Spanish companies in the acquisition of non-Spanish resident European Union targets, making it incompatible with the European Union single market. The EC limited the effect of its decision, however, to any tax deductions taken under this law after 21 December 2007, when these EC proceedings were commenced, reasoning that the companies who took these tax deductions had “legitimate expectations” that this Spanish tax law was valid and did not conflict with European Union state aid provisions. Since Logista acquired its European Union-investment in 2004, it will not have to reimburse the amounts of its tax deductions, which amounted to approximately €63 million (approximately £49 million) as of 30 September 2014.

Several companies have appealed the decision before the General Court of the European Union. Most of the appeals contend that the measure did not entail State aid and that the principle of legitimate expectations should have been extended until the publication of the final decisions in the official Journal. The only exception is the appeal filed by a non-Spanish entity against the acknowledgement of the existence of legitimate expectations prior to 21 December 2007.

In a decision delivered on 7 November 2014, the General Court of the European Union has annulled the EC decision on the basis that the EC has failed to demonstrate that the Spanish measure was selective. The judgement expressly excludes the possibility of recovering the tax benefits.

The EC may now appeal to the Court of Justice of the EU within two months from the notification.

As a consequence, the amount deducted by Logista related to the European Union operation would only be subject to a recovery order if the Court of Justice of the EU, following an appeal by the EC, annulled the 7 November judgment and allowed the appeal related to the legitimate expectation.

(d) ***Litigation by trade unions***

In January 2006, Altadis S.A.U. (**Altadis**) and Logista discontinued the supply of tobacco products to certain of their current and retired employees as a result of Spanish legislation prohibiting, amongst other things, the sale and supply of tobacco products by means other than through authorised outlets. Certain trade unions issued legal proceedings against Altadis and Logista and in July 2006, the Court of First Instance in Spain ruled that the companies’ decisions to discontinue the supply were lawful but that they were obliged to compensate the relevant employees with the point-of-sale cash equivalent. Both parties appealed this decision to the Spanish Supreme Court. On 8 April 2008 and 18 April 2008 respectively, the Supreme Court held that Altadis and Logista were right to discontinue the supply of tobacco products to their employees and that they should substitute the supply of tobacco products with cash, but not at their retail price. In September 2014, agreement was reached with a number of the relevant retired employees to settle outstanding compensation due to those individuals. The settlement agreement and process was challenged by the trade unions, and on 9 October 2014, the Labour Chamber of the National Court in Spain ruled in favour of the trade unions in the first instance. Altadis

intends to appeal the ruling to the Spanish Supreme Court and following external legal advice, Imperial believes that there are strong grounds for considering that this ruling will not be upheld by the Supreme Court. Imperial estimates the net present value, at September 2014, of any remaining compensation which may be paid by Altadis, Imperial Tobacco España S.L.U., Tabacalera S.L.U. and Logista to be approximately £70 million, in aggregate. Appropriate provisions exist in the companies' statutory accounts.

(e) ***Other U.S. litigation***

On 20 November 2014, a complaint was filed in the federal trial court in Philadelphia, Pennsylvania against Commonwealth Brands, Inc., Altadis USA, and Commonwealth-Altadis, Inc., each being subsidiaries of Imperial, and a third party by Satnam Distributors LLC alleging violations of various U.S. antitrust laws. The proceedings are at a very initial stage and the claims cannot, at this stage, be quantified.

## **10.2 Acquired Assets**

Except as set out below, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which Imperial is aware) during a period covering the previous 12 months preceding the date of this document which may have, or have had in the recent past, a significant effect on the financial position or profitability of the Acquired Assets:

(a) ***Acquired Tobacco Cigarette Brands***

Certain members of the Reynolds Group and certain members of the Lorillard Group are, in respect of the Acquired Tobacco Cigarette Brands, subject to ongoing, pending and threatened product liability proceedings in the U.S. including: (a) individual claims alleging personal injury or death; (b) class actions alleging personal injury or requesting court-supervised programmes for ongoing medical supervision and monitoring; (c) claims brought to recover the costs of providing health care; and (d) claims in relation to the labelling of products as "light" or "ultra light". However, as the Acquired Tobacco Cigarette Brands are being acquired without historic product liabilities, these proceedings and the respective quantum of such claims are not described in further detail in this document.

(b) ***blu Brand***

On 7 April 2014, LOEC filed a complaint for declaratory judgment of trademark non-infringement against Zippmark, Inc. (**Zippmark**) and Zippo Manufacturing Company (**ZMC**) (together **Zippo**) in the United States District Court for the Central District of California. The lawsuit was predicated by Zippmark's decision to file oppositions with the United States Patent and Trademark Office's Trademark Trial and Appeal Board against Lorillard Technologies, Inc.'s (**LTI**) applications to register certain trademarks for BLU and allegations that Lorillard infringed several of Zippo's registered trademarks. On 19 May 2014, Zippo filed an answer and counterclaim for trademark infringement. Zippo's counterclaim is for, amongst other things, injunctive relief, treble damages and an accounting of profits (unspecified sums), attorneys fees and costs. On 12 June 2014, LOEC filed its answer to Zippo's counterclaim and filed its own counterclaim seeking to cancel certain Zippo trademarks based on descriptiveness and for false/fraudulent registration. On 7 July 2014, Zippo responded to LOEC's counterclaim and included a counterclaim in reply seeking to cancel LTI's registered trademark for BLU ECIGS. On 28 July 2014, LOEC filed an answer to Zippmark's counterclaim in reply for cancellation of LTI's registered trademark. On 11 August 2014, LTI filed its answer to Zippmark's counterclaim in reply for cancellation of its registered trademark. According to the minutes of a scheduling conference dated 21 July 2014, the cut-off date for discovery is set for 22 January 2015. The trial date is scheduled for 21 April 2015. At this stage in the proceedings, the value of this action is unquantifiable.

On 14 and 18 July 2014, ZMC filed three applications with the UK Intellectual Property Office (**UK IPO**) to declare invalid three International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK in class 34 and owned by LTI. On 29 August 2014, Cygnet UK Trading Ltd (**Cygnet**), a subsidiary of Lorillard, and LTI filed a claim against ZMC for: (a) groundless threats of infringement proceedings; and (b) declarations of non-infringement with respect to ZMC's Community Trade Mark numbers 004629689 and 005232211, and any other ZMC trade mark which



incorporates the word “BLU” or any word or logo immaterially different to it. Lorillard issued a press release on 3 September 2014 in relation to this claim entitled “Lorillard Subsidiaries Sue Zippo in the UK to Stop Unfounded Threats Against BLU ECIGS”. On 6 October 2014, LTI filed its notices of defence and counterstatement with the UK IPO with respect to its International Registrations for Trademarks for BLU ECIGS, *blu* eCIGS (stylised) and BLU CIGS protected in the UK. On 22 October 2014, ZMC entered a defence to Cygnet and LTI’s claim denying that it had made a groundless threat, and served a counterclaim alleging Cygnet’s and LTI’s use of the various *blu* marks infringed ZMC’s Community Trade Marks. ZMC’s counterclaim is for, amongst other things, injunctive relief, damages or an accounting of profits, and costs. On 19 November 2014, Cygnet and LTI filed its defence denying infringement of the Community Trade Marks and served a counterclaim to revoke those Community Trade Marks for non-use and/or invalidate the Community Trade Marks due to the fact that they are devoid of distinctive character, descriptive of the products in relation to which they are registered and, or in the alternative, are deceptive in relation to certain of the products in relation to which they are registered. On 10 December 2014, ZMC filed its defence to Cygnet and LTI’s counterclaim, denying that its Community Trade Marks are or were at any material time invalid. At this stage in the proceedings, the value of this action is unquantifiable.

On 15 April 2014, ZMC filed oppositions against CTM Application Nos. 12592572 *blu* eCIGS (stylised) and 12580651 BLU owned by LTI. ZMC has based its oppositions on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device. At this stage in the proceedings, the value of these oppositions is unquantifiable.

On 22 June 2014, ZMC filed cancellation actions in Austria in relation to LTI’s International Registrations numbers WO0000001051365, WO0000001058275 and WO0000001051607. No proceedings have been served on LTI. At this stage in the proceedings, the value of these actions is unquantifiable.

On 22 August 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140613A BLU owned by LTI. On 28 November 2014, ZMC filed an opposition against Croatian Trade Mark Application No. Z20140614A *blu* eCIGS (stylised) owned by LTI. ZMC has based its opposition on its earlier CTM Registration Nos. 5232211 BLU and 4629689 BLU & Device. At this stage in the proceedings, the value of these oppositions is unquantifiable.

On 6 August 2014, ZMC obtained a preliminary injunction from the District Court of Frankfurt am Main against Cygnet UK Trading Ltd., on the basis of ZMC’s Community Trademarks for BLU. The injunction was served on Cygnet UK Trading Ltd. on 26 November 2014. Cygnet UK Trading Ltd. is complying with the injunction and has ceased selling BLU e-cigarettes and related products in Germany.

On 7 May 2014 (issued on 25 August 2014), ZMC filed at the Trademark Appeal Board of the State Administration for Industry and Commerce of the People’s Republic of China three applications for the invalidation of LTI’s *blu* eCIGS (stylised) trademark with International Registration number 1058275, BLU ECIGS trademark with International Registration number 1051365 and BLU CIGS trademark with International Registration number 1051607 registered in class 34. With respect to International Registration No. 1051365 BLU ECIGS, ZMC has argued that LTI disclaimed of the word “ECIGS” and as a result the distinctive part of the mark must be constrained to “BLU”. On 30 September 2014, LTI filed its defence to the three invalidity actions against International Registration Nos. 1058275, 1051365 & 1051607. On 14 November 2014, LTI filed non-use cancellation proceedings against ZMC’s registration Nos. 4912199 and 6131784 in Class 34 and 6131785 and 6131786 in Class 4 for BLU & Device. At this stage in the proceedings, the value of these actions is unquantifiable.

Zippo has opposed LTI’s Canadian Trade-mark Application No. 1501523 for the mark BLU ECIGS & Design on the basis of prior rights and likelihood of confusion. Zippo cross-examined LTI’s President and LOEC’s Vice President of Marketing on 12 November 2014 and the transcript is required to be filed by 23 January 2015. At this stage in the proceedings, the value of this action is unquantifiable.

LOEC, Inc. is also a defendant in four lawsuits filed on 22 June 2012, 5 March 2014, 21 October 2014, and 2 December 2014 by Ruyan Investment (Holdings) Limited and its successor companies, Fontem Ventures and Fontem Holdings 1 B.V., both companies being owned and controlled by the Imperial Group in the United States District Court for the Central District of California, alleging infringement of certain patents owned by Fontem Holdings 1 B.V. and exclusively licensed to Fontem Ventures related to electronic cigarette technology. The first case filed 22 June 2012 has been stayed pending proceedings before the United States Patent and Trademark Office. The second case filed 5 March 2014 is currently stayed. The third and fourth cases filed 21 October 2014 and 2 December 2014 have not yet been served on LOEC. At this stage in the proceedings, the value of these actions is unquantifiable. Following completion of the Acquisition these lawsuits will be fully and finally resolved.

## **11. Estimated Financial Benefits**

In relation to the statement made in paragraph 6.2 of Part 2 of this document:

- 11.1 Intangible assets (including goodwill) relating to the Acquired Assets, and to be held within the U.S., will be amortised over a period of 15 years in line with current U.S. tax law. This creates an expected tax benefit, with a present value of approximately US\$1.5 billion.
- 11.2 The present value of the expected tax benefits is calculated by taking the assumed purchase price for the Acquisition post certain purchase price adjustments, and after deducting the expected book value of the fixed assets to be acquired and other intangible assets to be acquired which are not intended to be held within the U.S. tax group of the Imperial Group following completion of the Acquisition, to derive the book value of the intangible assets to be acquired that will be held within the U.S. tax group of the Imperial Group (fair value thereof and purchase price allocation to be determined following completion of the Acquisition). These are then assumed to be fully amortised on a straight-line basis over 15 years. The annual amortisation charge is assumed to be fully deductible for U.S. tax purposes from the annual taxable profits realised over the 15 year period against an assumed effective U.S. tax rate of 39 per cent. This benefit is then discounted at 7 per cent.
- 11.3 There can be no assurance that such financial benefits can be achieved in the time frame or at all. This statement of estimated financial benefits relates to future circumstances which by their nature involve risks, uncertainties, contingencies and other factors. As a result, the financial benefits referred to may not be achieved, or those achieved may be materially different from those estimated. These figures are unaudited numbers based on management estimates.
- 11.4 The estimated financial benefits summarised in this paragraph are contingent on the completion of the Acquisition and could not be achieved independently. They also reflect both the beneficial elements and relevant costs. The Board has determined that these estimated financial benefits can reasonably be expected to arise based on the Company entering into the Asset Purchase Agreement.

## **12. Working Capital**

Imperial is of the opinion that the Enlarged Group has sufficient working capital for its present requirements that is, for at least the next 12 months from the date of this document.

## **13. No Significant Change**

### **13.1 Imperial Group**

There has been no significant change in the financial or trading position of the Imperial Group since 30 September 2014, being the date of the Imperial 2014 Accounts.

### **13.2 Reynolds Business**

There has been no significant change in the financial or trading position of the Reynolds Business since 30 September 2014, being the date to which the historical financial information relating to the Reynolds Business included in Section C of Part 5 of this document was prepared.

### 13.3 *Lorillard Business*

There has been no significant change in the financial or trading position of the Lorillard Business since 30 September 2014, being the date to which the historical financial information relating to the Lorillard Business included in Section F of Part 5 of this document was prepared.

## 14. Consents

- 14.1 Credit Suisse has given and has not withdrawn its written consent to the inclusion in this document of its name and the references to it in the form and context in which they are included or referenced.
- 14.2 Goldman Sachs has given and has not withdrawn its written consent to the inclusion in this document of its name and the references to it in the form and context in which they are included or referenced.
- 14.3 PwC is a member firm of the Institute of Chartered Accountants in England and Wales and has given, and not withdrawn, its written consent to the inclusion of its report on the Historical Financial Information relating to the Reynolds Business in Section A of Part 5 of this document, its report on the Historical Financial Information relating to the Lorillard Business in Section D of Part 5 of this document and its report on the unaudited *pro forma* financial information in Section G of Part 5 of this document, in the form and context in which they appear.

## 15. Incorporation by reference

Your attention is drawn to the following information which is incorporated by reference into this document:

Reference document	Information incorporated by reference
Imperial's 2014 Annual Report and Accounts	Information on related party transactions set out in note IX in the notes to the consolidated financial statements for the year ended 30 September 2014 on page 119 of Imperial's 2014 Annual Report and Accounts
Imperial's 2013 Annual Report and Accounts	Information on related party transactions set out in note X in the notes to the consolidated financial statements for the year ended 30 September 2013 on page 136 of Imperial's 2013 Annual Report and Accounts
Imperial's 2012 Annual Report and Accounts	Information on related party transactions set out in note IX in the notes to the consolidated financial statements for the year ended 30 September 2012 on page 140 of Imperial's 2012 Annual Report and Accounts

## 16. Documents on display

Copies of the following documents will be available for inspection during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD up to and including the date of the General Meeting and for the duration of the General Meeting:

- (a) the articles of association of Imperial;
- (b) the Imperial 2014 Annual Report and Accounts, the Imperial 2013 Annual Report and Accounts and the Imperial 2012 Annual Report and Accounts;
- (c) the written consents referred to in paragraph 14 of this Part 6;
- (d) the Asset Purchase Agreement; and
- (e) this document and the Form of Proxy.



## PART 7

### DEFINITIONS AND GLOSSARY OF TERMS

The following expressions have the following meanings throughout this document, unless the context otherwise requires:

<b>Acquisition</b>	the proposed acquisition by ITG Brands (or another member of the Imperial Group) of the Acquired Assets by way of an asset purchase pursuant to the terms and conditions of the Asset Purchase Agreement and the Transfer Agreement;
<b>Acquired Assets</b>	the Brands and the associated assets, properties, licences, rights, employees and certain associated liabilities which are to be acquired by ITG Brands (or another member of the Imperial Group) pursuant to the Asset Purchase Agreement, as described in more detail in Part 4 of this document;
<b>Acquired Tobacco Cigarette Brands</b>	the tobacco cigarette brands in the U.S. known as <i>Winston</i> , <i>Salem</i> , <i>Kool</i> and <i>Maverick</i> and, if applicable, the <i>Doral</i> cigarette brand in the U.S.;
<b>Altadis</b>	Altadis S.A.;
<b>Altria Group</b>	Altria Group, Inc.;
<b>Annual Report and Accounts</b>	the annual report and financial information of Imperial which is published on Imperial's website and made up to the accounting reference date of 30 September each year;
<b>Asset Purchase Agreement</b>	the asset purchase agreement entered into by Imperial, ITG Brands and Reynolds on 15 July 2014, setting out the terms and conditions of the Acquisition, as described in more detail in Part 4 of this document;
<b><i>blu</i> or the <i>blu brand</i></b>	the "e-cigarette" brand known as <i>blu</i> , including the brand known as <i>SkyCig</i> ;
<b>Board</b>	the board of Directors of Imperial;
<b>Brands</b>	the Acquired Tobacco Cigarette Brands and the <i>blu</i> brand;
<b>Commonwealth Brands</b>	Commonwealth Brands, Inc.;
<b>Companies Act</b>	the Companies Act 2006, as amended;
<b>Company</b>	Imperial Tobacco Group PLC, a public limited company registered in England and Wales under registered number 03236483;
<b>Company's AGM</b>	The Company's annual general meeting scheduled to be held on 28 January 2015;
<b>Credit Suisse</b>	Credit Suisse Securities (Europe) Limited;
<b>CREST</b>	the relevant system, as defined in the CREST Regulations (in respect of which Euroclear U.K. and Ireland Limited is the operator as defined in the CREST Regulations);
<b>CREST Manual</b>	the manual, as amended from time to time, produced by Euroclear U.K. and Ireland Limited describing the CREST system and supplied by Euroclear U.K. and Ireland Limited to users and participants thereof;
<b>CREST Regulations</b>	the Uncertificated Securities Regulations 2001 (SI 2001 No. 01/378), as amended;
<b>Directors</b>	the directors of Imperial, whose names appear in paragraph 4 of Part 6 of this document;
<b>Disclosure and Transparency Rules</b>	the rules made by the FCA under Part VI of FSMA relating to the disclosure of information (as amended from time to time);
<b>DOJ</b>	the U.S. Department of Justice;

<b>DOJ Case</b>	the case filed in 1999 by the DOJ against, among others, Philip Morris USA, Inc. (as successor to Philip Morris, Inc.), R.J. Tobacco , Brown and Williamson Tobacco Company, Lorillard Tobacco, The Liggett Group, Inc. British American Tobacco (Investments) Ltd., The Council for Tobacco Research-USA, Inc. and the Tobacco Institute, Inc. with reference “Civil Action No. 99-2496 (GK)”, including all related appeals and proceedings;
<b>Effective Date</b>	12 December 2014 (being the latest practicable date before the publication of this document);
<b>Enlarged Group</b>	the Imperial Group and the Acquired Assets following completion of the Acquisition;
<b>EU or European Union</b>	the European Union first established by the treaty made at Maastricht on 7 February 1992;
<b>Euro or €</b>	are references to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the treaty establishing the European Community, as amended from time to time;
<b>Executive Directors</b>	the executive directors of Imperial;
<b>Facilities Agreement</b>	the facilities agreement dated 15 July 2014 and made between, amongst others, Imperial Tobacco Finance PLC and Imperial Tobacco Enterprise Finance Limited as borrowers, Imperial and Imperial Tobacco Limited as guarantors and The Royal Bank of Scotland plc as facility agent;
<b>FCA</b>	the Financial Conduct Authority of the United Kingdom;
<b>FDA</b>	the U.S. Food and Drug Administration;
<b>Fitch</b>	Fitch Ratings Limited;
<b>Fontem Ventures</b>	Fontem Venture B.V.;
<b>Form of Proxy</b>	the form of proxy for use at the General Meeting;
<b>FSMA</b>	the Financial Services and Markets Act 2000, as amended from time to time;
<b>FSPTC Act</b>	The Family Smoking Prevention and Tobacco Control Act 2009;
<b>FTC</b>	U.S. Federal Trade Commission;
<b>GBP or £</b>	the lawful currency of the U.K. from time to time;
<b>General Meeting</b>	the general meeting of Imperial to be held at 3:00 p.m. or immediately following the conclusion of the Company’s AGM, whichever is the later, on 28 January 2015 at the Bristol Marriott Hotel City Centre, 2 Lower Castle Street, Old Market, Bristol, BS1 3AD, notice of which is set out in Part 8 of this document;
<b>Goldman Sachs</b>	Goldman Sachs International;
<b>HSR Act</b>	Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations promulgated thereunder;
<b>Imperial</b>	Imperial Tobacco Group PLC, a public limited company registered in England and Wales with registered number 03236483;
<b>Imperial 2014 Accounts</b>	the annual audited consolidated accounts of Imperial for the year ended 30 September 2014, including the accountant’s notes and the auditor’s opinion on them as set out at pages 66 to 122 of Imperial’s 2014 Annual Report and Accounts;
<b>Imperial Group</b>	Imperial and its subsidiaries from time to time and, where the context requires, each one of them;
<b>Imperial Shares</b>	the Ordinary Shares;
<b>ITG Brands</b>	ITG Brands, LLC (formerly called Lignum-2 L.L.C.), a Texas limited liability company and wholly-owned subsidiary of Imperial;

<b>Lantern Acquisition Co.</b>	Lantern Acquisition Co., a Delaware corporation and wholly-owned subsidiary of Reynolds;
<b>Listing Rules</b>	the Listing Rules made by the FCA under Part VI of FSMA (as amended from time to time);
<b>London Stock Exchange</b>	London Stock Exchange plc;
<b>Lorillard</b>	Lorillard, Inc., a corporation incorporated under the laws of Delaware;
<b>Lorillard Business</b>	the Acquired Assets that are owned by, or relate to, the Lorillard Group as at the date of this document;
<b>Lorillard Group</b>	Lorillard and its subsidiaries from time to time and, where the context requires, each one of them;
<b>Lorillard Tobacco</b>	Lorillard Tobacco Company, a Delaware corporation and wholly-owned subsidiary of Lorillard;
<b>Member State</b>	a state which is a member of the European Union;
<b>Merger</b>	the merger between Lorillard and Lantern Acquisition Co. upon the terms contemplated by the merger agreement dated 15 July 2014, such that Reynolds will own 100 per cent. of the outstanding capital stock of Lorillard;
<b>Merger Agreement</b>	the agreement and plan of merger agreement entered into by Lorillard, Reynolds and Lantern Acquisition Co on 15 July 2014, setting out the terms and conditions of the Merger;
<b>Moody's</b>	Moody's Investor Services Limited;
<b>MSA</b>	the Master Settlement Agreement, dated as of November 23, 1998, among the 46 States, the District of Columbia and five U.S. territories listed on the signature pages thereto, Philip Morris USA, Inc. (as successor to Philip Morris Incorporated), R.J. Tobacco, Brown & Williamson Tobacco Corporation, Lorillard Tobacco and various SPMs as listed on the NAAG list of "Participating Manufacturers", as amended, supplemented or replaced;
<b>MSA Allocable Share</b>	has the meaning given to it in Exhibit A to the MSA;
<b>NAAG</b>	the National Association of Attorneys General in the U.S.;
<b>Non-Executive Directors</b>	the non-executive directors of Imperial;
<b>Notice of General Meeting</b>	the notice of the General Meeting contained in Part 8 of this document;
<b>OPM</b>	means an Original Participating Manufacturer as such term is defined in the MSA;
<b>Ordinary Shares</b>	fully paid ordinary shares of 10 pence each in the capital of Imperial;
<b>PwC</b>	PricewaterhouseCoopers LLP, a limited liability partnership registered in England with registered number OC303525 and whose registered office is 1 Embankment Place, London, WC2N 6RH;
<b>Reciprocal Manufacturing Agreement</b>	the reciprocal manufacturing agreement to be entered into between RJR Tobacco and ITG Brands upon completion of the Acquisition, as described in more detail in paragraph 4.1 of Part 4 of this document;
<b>Registrar</b>	Equiniti Limited;
<b>Resolution</b>	the resolution to be proposed at the General Meeting set out in the Notice of General Meeting;
<b>Reynolds</b>	Reynolds American Inc., a corporation incorporated under the laws of North Carolina;

<b>Reynolds Business</b>	the Acquired Assets that are owned by, or relate to, the Reynolds Group as at the date of this document;
<b>Reynolds Group</b>	Reynolds and its subsidiaries from time to time and, where the context requires, each one of them;
<b>RJR Tobacco</b>	R.J. Reynolds Tobacco Co., a North Carolina corporation and wholly-owned subsidiary of Reynolds;
<b>Route to Market Agreement</b>	the route to market agreement entered into by ITG Brands and Reynolds on 15 July 2014, as described in more detail in paragraph 4.2 of Part 4 of this document;
<b>SEITA</b>	Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes S.A.;
<b>Shareholder</b>	a holder of Imperial Shares from time to time;
<b>SPM</b>	means a Subsequent Participating Manufacturer as such term is defined in the MSA;
<b>Sponsor</b>	Credit Suisse;
<b>Standard &amp; Poor's</b>	Standard & Poor's Credit Market Services Europe Limited;
<b>States</b>	the 50 States and Commonwealths of the United States, the District of Columbia and any U.S. territory or possession, including, but not limited to, Puerto Rico, American Samoa, Guam, the U.S. Virgin Islands and the Commonwealth of the Northern Marianas Islands, all of them and each of them, as the context shall require;
<b>Transfer Agreement</b>	the transfer agreement entered into by ITG Brands and Lorillard on 15 July 2014, as described in more detail in paragraph 3 of Part 4 of this document;
<b>U.K.</b>	the United Kingdom;
<b>U.S. or United States</b>	the United States of America including, as the context shall require the District of Columbia and any U.S. territory or possession, including, but not limited to, Puerto Rico, American Samoa, Guam, the U.S. Virgin Islands and the Commonwealth of the Northern Marianas Islands; and
<b>US\$, \$ or U.S. dollar</b>	the lawful currency of the U.S. from time to time.

## GLOSSARY

### Growth Brands

Our key strategic and focus brands have been grouped together and are now managed as Growth Brands. They are: *Davidoff*, *Gauloises Blondes*, *JPS*, *West*, *Fine*, *News*, *USA Gold*, *Bastos*, *Lambert & Butler* and *Parker & Simpson*.

These are high quality brands with strong consumer appeal and, with the exception of the recently launched *Parker & Simpson*, established positions in key markets. We have successfully developed a number of these brands into total tobacco offerings, providing consumers with both cigarette and fine cut tobacco options.

We're managing these brands to collectively drive quality volume, share and revenue growth over the long term. We measure the performance of our Growth Brands against volume, share and revenue metrics.

### Growth Markets

Growth Markets are characterised by large profit and/or volume pools. We tend to have shares below 15 per cent. and see considerable opportunities for share and profit growth over the long term.

Our main Growth Markets include the U.S. and selected markets in the European Union, Eastern Europe, Asia and the Middle East.

We measure the performance of our Growth Markets against share, volume and revenue metrics and our quality of growth by the progress our Growth and Specialist Brands are making.

### Returns Markets

In Returns Markets we have relatively large shares, mostly above 15 per cent. Our objective is to maximise profit, whilst actively managing our market share.

Our main Returns Markets include the U.K., Germany, and other markets in the European Union, Australia, Eastern Europe and Africa.

We measure the performance of our Returns Markets against share and revenue metrics and our quality of growth by the progress our Growth and Specialist Brands are making.

### Specialist Brands

Our Specialist Brands consist of a range of cigarette, fine cut tobacco, paper, cigar and smokeless tobacco brands. We are world leader in fine cut tobacco, premium cigars and papers and hold a strong position in Scandinavian snus.

Specialist Brands have strong positions in their own categories and appeal to specific consumer groups. They are: *Style*, *Gitanes* (cigarettes), *Golden Virginia*, *Drum*, *Route 66* (fine cut tobacco), *Cohiba*, *Montecristo*, *Romeo Y Julieta* (premium cigars), *Backwoods* (cigars), *Skruf* (snus) and *Rizla* (papers).

These brands generate strong returns and we measure their performance against revenue metrics.

## PART 8

### NOTICE OF GENERAL MEETING

## Imperial Tobacco Group PLC

(Incorporated and registered in England and Wales with registered number 03236483)

### NOTICE OF GENERAL MEETING

NOTICE IS GIVEN that a GENERAL MEETING of IMPERIAL TOBACCO GROUP PLC (the **Company**) will be held at 3:00 p.m. or immediately following the conclusion of the Company's annual general meeting, whichever is the later, on 28 January 2015 at the Bristol Marriott Hotel City Centre, 2 Lower Castle Street, Old Market, Bristol, BS1 3AD (the **General Meeting**) to consider and, if thought fit, pass the following resolution as an ordinary resolution:

#### ORDINARY RESOLUTION

THAT the proposed acquisition by the Company, and/or any one or more of its subsidiaries, of brands and assets, including the U.S. cigarette brands *Winston*, *Maverick*, *Kool* and *Salem* and the U.S. and international e-cigarette brand *blu*, including certain employees, offices, production facilities and commercial infrastructure, currently owned by Reynolds American Inc. and Lorillard, Inc. and their respective affiliates (the **Acquisition**), substantially on the terms and subject to the conditions of the asset purchase agreement dated as of 15 July 2014 by and among the Company, ITG Brands, LLC (formerly called Lignum-2 L.L.C.), being a wholly owned subsidiary of the Company, and Reynolds American Inc. (the **Asset Purchase Agreement**), summarised in Part 4 of the circular to shareholders of the Company dated 15 December 2014 (the **Circular**), and all other agreements and ancillary documents contemplated by the Asset Purchase Agreement, be and are approved and the directors of the Company (or any duly authorised committee of the directors) (the **Board**) be authorised:

- (a) to do or procure to be done all such acts and things on behalf of the Company and any of its subsidiaries as the Board considers necessary, desirable or expedient to implement, or otherwise in connection with, the Acquisition; and
- (b) to agree such modifications, variations, revisions, waivers, extensions, additions or amendments to any of the terms and conditions of the Acquisition and/or to any documents relating to it, as they may in their absolute discretion think fit, provided such modifications, variations, revisions, waivers, extensions, additions or amendments are not of a material nature.

#### By order of the Board

John Downing  
*Company Secretary*

15 December 2014

Registered No: 03236483. Registered office: 121 Winterstoke Road, Bristol, England, BS3 2LL

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#### Notes:

1. Only holders of the fully paid ordinary shares of 10 pence each in the capital of the Company (the **Ordinary Shares**) are entitled to attend and vote at the General Meeting. A member entitled to attend and vote is entitled to appoint a proxy or proxies to attend, speak and vote instead of him/her. A member may appoint more than one proxy provided that each proxy is appointed to exercise the rights attached to a different Ordinary Share or Ordinary Shares held by him/her. A proxy need not be a member of the Company.
2. You may appoint your proxy electronically at [www.sharevote.co.uk](http://www.sharevote.co.uk). You will need the Voting I.D., Task I.D. and Shareholder Reference which together make up your personal voting reference number printed on the front of the proxy form enclosed with this notice. Alternatively, if you have already registered with the Company's registrar, Equiniti Limited's, online portfolio service, Shareview, you can submit your proxy form at [www.shareview.co.uk](http://www.shareview.co.uk). For further information, see the instructions printed on the proxy form. You are advised to read the terms and conditions of use carefully. Any electronic communication found to contain a computer virus will not be accepted.
3. As an alternative to appointing your proxy electronically a proxy form is enclosed with this notice and instructions for its completion are shown on the form. Proxy forms and the power of attorney or other authority, if any, under which it is signed or a certified copy of such power or authority need to be deposited with the Company's Registrar, Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom, not later than 3:00 p.m. on 26 January 2015 (or not less than 48 hours before the time of any adjourned meeting).
4. To appoint more than one proxy, (an) additional proxy form(s) may be obtained by contacting Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, United Kingdom on 0871 384 2037 (calls to this number are charged at 8 pence per minute plus network extras) or +44 (0) 121 415 7047 (lines open 8.30 am to 5.30 pm, Monday to Friday, excluding bank



holidays) or you may photocopy the form. Please indicate in the box next to the proxy holder's name the number of shares in relation to which they are authorised to act as your proxy (which, in aggregate, should not exceed the number of shares held by you). Please also indicate by ticking the box provided if the proxy instruction is one of multiple instructions being given. All forms must be signed and should be returned together in the same envelope.

5. Completion of a proxy form, either in electronic or paper format, does not preclude a member attending and voting in person at the General Meeting. A vote withheld option is provided on the proxy form to enable you to instruct your proxy not to vote on any particular resolution. It should, however, be noted that a vote withheld in this way is not a 'vote' in law and will not be counted in the calculation of the proportion of the votes 'For' and 'Against' a resolution.
6. A member must inform the Company's registrar in writing of any termination of the authority of a proxy.
7. Alternatively, if you are a member of CREST, you may register the appointment of a proxy by using the CREST electronic proxy appointment service. Further details are contained below.

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for the General Meeting and any adjournment(s) thereof by using the procedures, and the address, described in the CREST Manual (available via [www.euroclear.com](http://www.euroclear.com)). CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a **CREST Proxy Instruction**) must be properly authenticated in accordance with Euroclear U.K. & Ireland Limited's (EUI) specifications and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or relates to an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA19) by the latest time(s) for receipt of proxy appointments specified in the notice of the General Meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST applications host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors or voting service providers should note that EUI does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that his/her CREST sponsor or voting service provider(s) take(s) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

8. If two or more valid but differing appointments of a proxy are received in respect of the same share for use at the same meeting, the one which is last received (regardless of its date or the date of its signature) shall be treated as replacing and revoking the others as regards that share; if the Company is unable to determine which was last received, none of them shall be treated as valid in respect of that share.
9. Any or all joint holders of shares may attend the General Meeting, although only one holder may vote in person or by proxy. In the case of joint holders, where more than one of the joint holders purports to vote or to appoint a proxy, only the vote or appointment submitted by the most senior holder will be accepted. Seniority is determined by the order in which the names of the joint holders appear in the Company's register of members in respect of the joint holding (the first-named being the most senior).
10. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, in order to be able to attend and vote at the General Meeting (either in person or by proxy, and also for the purposes of calculating how many votes a person may cast), a person must have his/her name entered on the register of members of the Company at 6.00 p.m. on 26 January 2015 (the **Specified Time**). Changes to entries on the register of members after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting. Should the General Meeting be adjourned to a time not more than 48 hours after the Specified Time, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes a person may cast) at the adjourned General Meeting. Should the General Meeting be adjourned for a longer period, to be so entitled members must have been entered on the register of members by 6.00 p.m. two days prior to the adjourned General Meeting or, if the Company gives notice of the adjourned General Meeting, at the time specified in such notice.
11. A person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 (the **Companies Act**) to enjoy information rights (a **Nominated Person**) may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.

The statements of the rights of members in relation to the appointment of proxies in this notice do not apply to a Nominated Person. The rights of members in relation to the appointment of proxies can only be exercised by registered members of the Company. Nominated Persons are reminded that they should contact the registered holder of their Ordinary Shares (and not the Company) on matters relating to their investments in the Company.

12. Copies of the documents listed in paragraph 16 of Part 6 of the Circular are available for inspection at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD during normal business hours from the date of this notice until the close of the General Meeting (Saturdays, Sundays and public holidays excepted) and will be available for inspection at the place of the meeting during the meeting.
13. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that, if more than one, they do not do so in relation to the same Ordinary Shares.
14. Under section 319A of the Companies Act, a member attending the meeting has the right to ask questions in relation to the business of the meeting. The Company must cause to be answered any such question relating to the business being dealt with at the meeting but no such answer need be given if (a) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, (b) the answer has already been given on a website in the form of an answer to a question, or (c) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered. The Chairman may also nominate a Company representative to answer a specific question after the General Meeting.
15. A copy of this notice and other information required by section 311A of the Companies Act can be found on the Company's website ([www.imperial-tobacco.com](http://www.imperial-tobacco.com)).
16. In accordance with the Company's established practice, all resolutions will be taken on a poll so as to accurately record the decision of all members based on their shareholding interests in the Company. As at 12 December 2014 (being the last practicable day prior to publication of this notice) the Company's issued share capital consisted of 1,036,000,000 Ordinary Shares carrying



one vote each (including 78,909,137 Ordinary Shares held by the Company in treasury which do not carry any voting rights). The total number of exercisable voting rights in the Company as at 12 December 2014 was, therefore, 957,090,863.

17. As soon as practicable following the General Meeting, the results of the voting at the meeting and the numbers of all votes cast for and against and the number of votes actively withheld in respect of all resolutions will be announced via a Regulatory Information Service and also placed on the Company's website [www.imperial-tobacco.com](http://www.imperial-tobacco.com).
18. You may not use any electronic address (within the meaning of section 333(4) of the Companies Act) provided either in this notice or in any related documents (including the Chairman's letter and proxy form) to communicate with the Company for any purposes other than those expressly stated.

